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CURRENT STATE OF MANUFACTURING INDUSTRIES

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

JUNE 21, 2001

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

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CURRENT STATE OF MANUFACTURING INDUSTRIES

THURSDAY, JUNE 21, 2001

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 10 a.m. in room SR–253, Russell Senate Office Building, Hon. Ernest F. Hollings, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM SOUTH CAROLINA

The CHAIRMAN. Good morning. The Committee will come to order. What we have this morning is a hearing on the current state of the American manufacturing industry. It is a very important panel: Mr. Dean Baker, the Co-Director of the Center for Economic Policy Research; Mr. Jeff Faux, President of the Economic Policy Institute; Mr. Dan Griswold, Associate Director of the Center for Trade Policy at the Cato Institute; and Dr. Jerry Jasinowski, the head of the National Association of Manufacturers.

It was only yesterday that I was able to contact Dr. Jasinowski. When I looked up and saw that we were going to have a hearing on manufacturing and did not have the head of the manufacturers association. I picked up the phone, and he readily agreed to come and give us his testimony with the caveat that he had to get out early.

So let me start, Dr. Jasinowski. The full statements of all four witnesses will be included in their entirety into the record and we will ask you to summarize them in a 5-, 10-minute fashion.

Dr. Jasinowski.

STATEMENT OF JERRY JASINOWSKI, PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. JASINOWSKI. Thank you, Chairman Hollings. You honor me by including me in this important panel and I appreciate it on behalf of our 14,000 large and small companies. I want to thank you and your leadership on focusing on manufacturing, which is right now in recession, and I think that there is the threat that, given the poor condition of manufacturing in a cyclical sense, it is possible that the economy more generally could face recession. I want to talk on that as one of my points today.

The other three points I want to make is that the U.S. manufacturing, however, continues to be internationally quite competitive and that trade is in general positive with respect to manufacturing output and employment, and then I want to talk a little bit about the policies that we need in order to move manufacturing out of recession and also the move manufacturing forward on the trade front.

I also want to acknowledge Senator Dorgan, who has been a person who we have worked with on issues having to do with manufacturing and interest rates.

First of all, I will ask that my full prepared testimony be included in the record, and you have already acknowledged that I would be. I want to just draw to the conclusions of that in order to be as brief as I can. If you turn to the conclusions of that prepared statement, which is at the very end, of course, it says on page 10:

> "Because of America's increasing competitive edge in the global marketplace, we have been able since the mid–1980's to expand our exports in the world economy, which have increased from less than 7 percent to more than 14 percent of domestic output. Over the same period, America's share of world exports has increased by 20 percent."

Other charts in this prepared statement and information indicate that manufacturing productivity has been growing at more than 5 percent a year. That is why we have been able to expand our exports. That is why we continue to be internationally the most competitive manufacturing sector in the world. That has, again referencing a few charts in our prepared statement, allowed us to increase manufacturing compensation so that the average compensation for a manufacturing worker is $50,000 a year.

The final chart in the prepared statement, Mr. Chairman, shows that manufacturing employment had been increasing until 1999, not dramatically but consistently, even as the trade deficit in fact widened. Now, that is not to say that the trade deficit and international competition never reduces jobs. We all know that in some cases, such as apparel and footwear, it has. You know better than anyone that that is the case. I am not here to suggest that trade is an unmitigated positive for industry, either. It does increase price competition and because we are so exposed to the fluctuations in the international economy it can when the international economy turns down or the dollar is overvalued make things difficult.

Having said that, we believe that the vast aspect of international trade is positive for manufacturing and that the current recession in manufacturing has very little to do with international trade, with the exception, as you know, of the overvalued dollar with respect to the euro and the yen.

Turning to the charts that I have provided to the Committee, Mr. Chairman, you have a summary of what has caused this recession and I can go through those very quickly. You see that industrial production has dropped for the last 8 months and is now at the lowest level it has been since the last recession. Inventories as a result have jumped very sharply and so we have had an inventory recession in part.

Turning to the charts on page 2, as we all know, Senator Dorgan in particular and you, interest rates have been much too high. The Federal Reserve went too far in tightening interest rates and that has had a devastating impact on small business, farmers, and industry, and thank God that the chairman and others have reversed that course and we have had 3 percentage point reductions in interest rates. But it is essential, Mr. Chairman, that the Federal Reserve and Mr. Greenspan further reduce rates at the meeting next week by a half a percentage point.

But it is not just high interest rates that have caused this manufacturing recession. Last year energy costs took $115 billion out of the American economy and the manufacturing sector is the most sensitive sector to energy costs, and we use about a third of American energy.

The next item there is the euro exchange rate imbalance. As you will notice, in the Wall Street Journal today there is a long story talking about Mr. John Dillon of the Business Roundtable meeting with Secretary O'Neill yesterday and the NAM also having met with Secretary O'Neill, arguing that the overvalued dollar is killing American manufacturing and provides a 30 percent disadvantage to American manufacturing. There is a wide variety of ways that that can be dealt with and I would be prepared to respond to those.

Finally, on page 3 it shows that manufacturers have not been able to raise prices during this period despite all these cost increases. That means it is essential that we not pass legislation to further increase costs.

I want to thank you on behalf of the 14,000 manufacturing firms for your support of reducing regulation, including ergonomics, excessively costly ergonomics legislation. I would ask both of you to look carefully at the current health care reform to be sure that we do not damage American manufacturing by raising costs further at a time when you cannot raise prices and manufacturing is in recession.

Let me end by saying that I think we are bottoming out in this recession. We think that we can have a recovery late this year and we think that manufacturing, because of its productivity, technology, and all the other things mentioned in my prepared statement, are quite capable of competing in the long run and that we therefore ought to move forward with trade promotion authority and with a Free Trade Agreement for the Americas, as well as the other trade legislation that you have before you.

I would be happy to answer any questions, Mr. Chairman, and again want to thank you for including me in this hearing.

[The prepared statement of Mr. Jasinowski follows:]

PREPARED STATEMENT OF JERRY JASINOWSKI, PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS

The National Association of Manufacturers represents 14,000 American firms producing about 80 percent of all U.S. manufacturing output. Manufacturing comprises approximately one-fifth of all the goods and services produced by the U.S. economy, and directly supports 56 million Americans—the 18 million American men and women who make things in America and their families.

Trade is of great importance to the NAM, for more than 6 out of 10 dollars of total U.S. exports of goods and services are manufactured products. Last year, U.S. exports of manufactured goods were $690 billion, 88 percent of total U.S. merchandise exports. The $52 billion of agricultural goods exported last year accounted for 7 percent of U.S. merchandise exports, and mining and all other industries accounted for the remaining 5 percent.

Similarly, manufactured goods dominate our imports; last year, they accounted for 70 percent of all goods and service imports, or $1.014 billion.

About one-sixth of our total manufacturing output is exported and, for many important industries the ratio is much higher. For example, exports account for 54 percent of U.S. aircraft production, 49 percent of machine tools, 46 percent of turbine and generator output, 45 percent of printing machinery, and the list goes on.

BENEFITS OF TRADE TO MANUFACTURERS

Too often, the trade debate focuses on mercantilist arguments that exporting industries benefit from trade while those that compete with imports suffer. Unfortunately, this view, shared by both opponents and supports of free trade, misses the point. Together, industries where either imports or exports dominate make up just 1 percent of the economy. In reality, industries that account for the bulk of U.S. exports also compete with the bulk of imports coming into our country. In manufacturing, these industries that are globally engaged are the most prosperous. It's time to change the debate from *exports are good and imports are bad* to *trade means prosperity*.

Whether measured in terms of growth in output or incomes of workers, the industries that have been the most open to the world economy have fared much better during the past decade than the rest of the economy. That this is not widely known shows that there is much work to be done to explain what matters most is not exports or imports but openness to trade.

America is becoming more connected to the global economy. Between 1991 and 1999, trade (exports plus imports) rose from 12 percent to 14 percent of our nation's economic gross output[1]. As Table 1 shows, this increased engagement can be attributed to the manufacturing sector, which makes up more than two-thirds of U.S. trade. Apart from manufacturing, the rest of the economy, excluding farms, has remained fairly autarkic. So, it stands to reason that the effects of increased trade on the U.S. economy should be most evident in manufacturing.

Table 1.—Trade (exports+imports) as a Share of Gross Output

1991: Manufacturing—27%; Farms—18%; Rest of Economy—6%
1999: Manufacturing—36%; Farms—18%; Rest of Economy—6%

Export and import intensity tend to go hand in hand for nearly all (97 percent) of manufacturing. Industries that depend most on exports also compete most with imports. Industries that are least reliant on exports also have little import competition. Manufacturing industries roughly fit into four categories in terms of trade (see Table 2 below)*: most-open, open, least-open and import-dominated.*

Table 2.—Openness in Manufacturing

	Share of Gross Output (1999)		
	Exports (In percent)	Imports (In percent)	Trade (In percent)
Most Open: (Electronics, Industrial machinery, Transportation equipment and instruments)	26%	33%	59%
Open: (Primary/Fabricated Metals, Chemicals, Textiles, Furniture, Rubber/plastic products and Stone, clay glass products)	11	14	25
Least Open: (Lumber, Paper, Petroleum and coal products, Food, Tobacco and Printing/publishing)	5	6	11
Import-Dominated: (Leather, Apparel, Miscellaneous)	16	84	100

Source: NAM from Commerce Department Data.

The *most-open industries,* where exports and imports are each more than a quarter of domestic production, accounted for nearly 40 percent of manufacturing output and 60 percent of manufactured trade in 1999 (see Chart 1 attached.) Manufacturing industries that are slightly less *open* to international trade make up 30 percent of manufactured output and 20 percent of trade. The *least-open* manufacturing industries also account for 30 percent of manufactured output and just 10 percent of trade. Lastly, the *import-dominated* portion of manufacturing represents about 3 percent of manufactured output and 10 percent of manufactured trade.[2]

[1] Gross output consists of sales or receipts and other operating income; commodity taxes; and inventory change. Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, December 2000.

[2] In 1999, the gross output of import-dominated manufacturing industries was $144 billion; exports were $24 billion and imports were $122 billion.

Trade and Economic Growth

In the 1990s, manufacturing productivity grew at twice the rate of overall productivity. This is why change in real output and contribution to economic growth are much better ways to measure the health and importance of manufacturing than simply looking at employment levels. During 1991–1999, real GDP in manufacturing grew, on average, by 5.4 percent per year. This is nearly 40-percent faster than growth in the rest of the economy. In fact, manufacturers contributed to more than 21 percent of the increase in real GDP between 1991 and 1999—more than any other sector!

Three quarters of manufacturing growth came from *most-open* industries to trade, where real GDP growth averaged more than 12 percent per year between 1991 and 1999 (see Chart 2 attached.)

Critics of free trade often say that imports suppress domestic production. While this may be true in certain circumstances, the greater truth is that import growth is generated by a strong economy: The fastest-growing manufacturing industries in the 1990s competed directly with nearly 60 percent of all manufactured imports. Trade is not "hollowing out our manufacturing sector," as some claim. Rather, trade is helping it grow and become stronger.

So, when one asks how has manufacturing been affected by trade, the answer is that the *most-open* industries that compete directly with more than half of all manufactured imports and are responsible for roughly two-thirds of manufactured exports, grew at triple the pace of the overall economy between 1991 and 1999. Has globalization marginalized America's manufacturing base? Clearly the answer is no. Globalization has helped the manufacturing sector to evolve and become stronger.

Trade and the Manufacturing Worker

Those who work in the *most-open* industries within manufacturing have seen their wages and salaries grow the fastest in the 1990s.

By the end of the 1990s, a full-time employee in manufacturing earned, on average, $50,000 per year—20 percent more than the average throughout the rest of the economy. For the vast majority of manufacturing, trade and worker compensation are closely and positively related: the more industries are open to trade, the more workers get paid. In 1999, worker compensation ranged from more than $60,000 in *most-open* industries to $44,000 in industries *least-open* to trade (see Chart 3 attached.)

As economies become more internationally engaged, they focus increasingly on what they have a comparative advantage in producing. In the case of the United States, our comparative advantage lies in the skill of our workers and the technologies they use to build the world's most sophisticated products more efficiently than anyone else. This is why the fastest growing sectors within manufacturing have been in industries that are highly capital intensive and compensate workers with a premium wage.

Between 1991 and 1999, overall manufacturing employment grew by 263,000[3]. At the same time, 18.9 million jobs in other sectors were created. Within manufacturing, the only contraction in employment occurred in *import-dominated* industries, where the number of full-time workers fell by 310,000. Employment elsewhere in manufacturing grew by 573,000. Trade opponents often cite the loss of jobs within apparel manufacturing as solid evidence that imports destroy jobs. While there is no doubt that many of the job losses in this sector have been due to competition from overseas, it is important to keep in mind that *import-dominated* industries represent just 3 percent of manufacturing output, 6 percent of manufacturing employment and competed with just 14 percent of manufactured imports.

Still, the fact that our nation imports nearly as much as we produce of apparel, leather goods, and miscellaneous manufacturing shows that America does not have a comparative advantage in producing goods which depend on semi-skilled labor. To remain competitive, American firms have turned increasingly to technology and automation, and to higher-end products within the sector. This has lead to rapid increases in compensation within the *import-dominated* sector of manufacturing during the 1990s discussed below.

Overall, real compensation for a full-time worker in manufacturing in the 1990s rose by 11 percent, slightly faster than the 10 percent rise in worker pay elsewhere in the economy. Within manufacturing, compensation growth and trade are very closely and positively related, not negatively as trade opponents often claim (see Chart 4 attached.)

[3] Employment in full-time equivalents, as reported by the Commerce Department's Bureau of Economic Analysis.

During the 1990s, compensation in both the *most-open* industries as well as *the import-dominated* sector grew by 13 percent in real terms, while income growth in the more autarkic sectors of manufacturing was a bit slower.

For the *import-dominated* industries, the companies that survived the past decade were those that were able to either focus on high-end manufacturing or employ new technologies to stay competitive with overseas competition. Both of these practices depended on a skill level not previously associated with this sector of manufacturing. For example, to remain competitive, shoe manufacturers now use computer-aided design and computer-aided manufacturing to increase quality, enhance design capability and lower production costs. This is evidenced by the fact that labor productivity for non-rubber footwear rose at an annual compound rate of 6 percent during the first half of the 1990s. Thus, even in *import-dominated* industries, international competition has served to raise worker competition and skill levels.

As for the *most-open* sector of manufacturing, which competes with the majority of imports and accounts for most of manufactured exports, being successful in international trade is based on employing skills of American manufacturers' highly trained workforce, who command premium pay for their work. Whether you are a worker or a business owner, globally engaged industries are where you want to be.

The Trade Deficit Does Not Cost Jobs

Some have argued that because the United States runs a trade deficit, trade is a net job destroyer. Essentially, the argument goes like this: Between 1992 and 1999, the United States created 20.7 million jobs. At the same time, the country's gross domestic product (GDP) grew by $1.976 trillion after adjusting for inflation. So, every $1 billion change in real GDP, positive or negative, affects 10,492 jobs. For example, personal consumption expenditures rose by $1.397 billion between 1992 and 1999, "creating" ($1.397 x 10,492) 14.7 million jobs. At the same time, our country's trade deficit grew by $304 billion, thus "destroying" ($304 billion x 10,492) 3.2 million jobs.

As it turns out, allocating job losses and gains to each GDP component is based on a conceptually flawed understanding of the role that net exports (the trade balance) play in national income accounting.

While many know that a nation's GDP, or C+I+G+(X-M), measures the value of goods and services produced domestically by adding up the purchases of final users: consumption (C), gross private-domestic investment (I), government expenditures (G) and the rest of the world (X-M)—the reason for the net export term is not commonly understood.

Exports are a positive entry in GDP as sales to foreigners. Imports are a negative entry that include final goods (purchased by C, I and G) plus intermediate products, like industrial supplies, that are inputs into domestic production. Just as exports are counted as value-added to the United States, imports of both intermediate and final products are counted as value-added to other nations. In other words, U.S. imports are other nations' exports. In standard national income accounting, exports and imports are combined into *net exports* (X-M).

Imports are combined with exports to create the net export term because once imports enter our country, they are seamlessly absorbed into the vast flow of economic transactions that take place every day in our country at both intermediate and final-demand levels of the economy. This adds complexity to computing GDP. When consumer demand is estimated by the Commerce Department, for example, the purchase of a domestically produced good or service cannot be differentiated from an imported one: Consumer purchases of motor vehicles, for example, include purchases of domestically produced Fords, as well as Audis made in Germany. Moreover, imported motor-vehicle components that make up part of the value of domestically produced cars are trucks, which are also included in the consumption component of GDP. This same problem exists for the other domestic components of GDP.

So imports, already embodied in the C, I and G components of domestic demand, are removed from GDP by combining them with exports to create the term net exports. This is why the net export term is necessary in national income accounting. While it does measure the difference between domestic demand for foreign products and foreign demand for U.S. goods and services, the trade balance is not a factor of production that creates or destroys jobs. Rather, it is an accounting measure used to remove imports that are already included in the domestic components of GDP.

The paragraphs above show that the *trade deficit=net job loss* figures are inaccurate. Did the $1.397 billion growth in consumption between 1992 and 1999 really create 14.7 million jobs? No. Some of what consumers purchased was imported! The only way to accurately measure the number of jobs created by growth in consumer demand is to remove imports already embodied in the consumption component of GDP. Then you have a true measure of the domestic production required to fill consumer demand. The same thing goes for the other components of the economy: I and G. Once this is done, the net export term no longer exists—imports have been allocated to their respective components of GDP.

Mexico, Germany, Japan and the United States Provide Further Evidence Disproving the Trade-Deficit Job Loss Myth

Another way to show that *the trade deficit=net job loss* just doesn't add up is to look at the bilateral trade balance with Mexico. According to free-trade opponents, the $63 billion growth in the U.S. trade deficit with NAFTA between 1993 and 2000 cost our country roughly 770,000 jobs.

One-third of our Mexican deficit comes from oil imports that we need to fuel our economy. The rest is in manufacturing trade. As it turns out, the manufactured trade deficit with Mexico can be attributable to motor vehicles trade. That's right. Excluding motor vehicles, the United States has run a manufactured trade surplus in all but one year since the NAFTA was enacted in 1994. In 2000, this surplus totaled $6.7 billion. Therefore, it stands to reason that if trade deficits by definition lower U.S. production and cost jobs, then the job losses caused by the U.S.-Mexico deficit must have taken place primarily in the auto sector.

However, instead of losing jobs, the number of full-time equivalent workers in the auto sector increased more than 20 percent between 1994 and 2000—faster than overall employment growth. Our auto industry employs more than 100,000 *more* workers today than before NAFTA, because U.S. production has grown so fast. Since 1994, real GDP in the motor-vehicles industry has grown at an average annual rate of 4.8 percent, surpassing overall GDP growth by nearly 25 percent. By comparison, during the six years prior to NAFTA, motor-vehicle output grew at an average pace of just 1.1 percent, less than half the growth rate of the economy as a whole.

The overall experiences of Germany, Japan and the United States in the 1990s further buttress the fact that trade deficits do not cause job losses. Between 1991 and 1999, Germany and Japan experienced rising trade surpluses and simultaneous reductions in manufacturing employment. At the same time, U.S. manufacturing employment remained relatively constant while our trade deficit expanded.

- Germany's merchandise trade surplus grew from $13 billion to $71 billion, while manufacturing employment declined 25 percent from close to 12 million to less than 9 million (see Chart 5 attached.)
- Japan's merchandise trade surplus grew from $78 billion to $108 billion, while manufacturing employment declined 13 percent from more than 15 million to 13 million (see Chart 6 attached.)
- The U.S.'s merchandise trade balance fell from –74 billion to –350 billion, while manufacturing employment remained roughly the same at 18.5 million (see Chart 7 attached.)

In fact, the state of domestic economics, not trade balances, determines employment levels in industrial nations. The performance of the American economy in the past six months bears this out. Due to high interest rates in 2000, a surge in energy prices, an inventory overhang, a stock market correction and a strong dollar that has suppressed exports, American industrial production has been on the decline since the fourth quarter of last year. Concurrently, imports fell by 1 percent in the fourth quarter and 9 percent in the first quarter of 2001.

There is no doubt that engagement in international trade affects America's labor force. While there is no doubt that just as trade creates employment opportunities for many, others are displaced by competition from abroad. However, labeling U.S. involvement in international trade as a net loss for American workers, due to the existence of a trade deficit, while great political theatrics, is a bogus claim that distracts policy-makers from engaging in a constructive dialog on the real challenges and opportunities that expanded trade offers our country.

International trade is not pain-free. Just like the adaptation of new technologies, international trade causes a certain amount of turmoil in the economy. And government has an appropriate role in aiding those who have been hurt by trade.

CHALLENGES FOR THE FUTURE

A New WTO Round

The NAM seeks the launch of a new trade round at the Doha Ministerial that would be based on broad agreement that the negotiations should seek sharp reductions in trade barriers facing industrial goods, as well as agriculture and services.

Over the years, the WTO and its predecessor, the GATT (General Agreement on Tariffs and Trade) succeeded in sharply reducing tariffs industrial nations charged on manufactured goods, and also began to have trade rules cover such things as intellectual property, standards, government procurement, etc. Disciplines on agriculture and services, however, are still very weak. Additionally, many developing nations still maintain high tariffs on manufactured goods.

The NAM wants a new round to include among its priorities a focus on reducing industrial tariffs, particularly in developing countries. Bound tariff rates on industrial goods average 35 percent in South America, and 28 percent in Southeast Asia. By comparison, the average U.S tariff binding for industrial goods is only 3.9 percent.

An increasing amount of world trade takes place among developing countries, and some of the highest trade barriers faced by developing countries are those imposed by other developing countries. Accordingly, developing countries could be among the largest beneficiaries of sharp reductions in industrial tariffs globally. Both developed and developing countries would also benefit from a WTO agreement increasing transparency of government procurement—an agreement that would tend to reduce corruption and wasted resources in developing countries.

Free Trade Area of the Americas (the FTAA)

The NAM's top trade priority is the creation of the Free Trade Area of the Americas (the FTAA). The reason for this is that the FTAA would strongly affect the bottom line for American industry. It is of major significance to U.S. manufacturing production and employment, it is achievable in a near-term time frame; and it is of utmost importance.

There are two areas of the world where barriers are still high: South America and Southeast Asia. The FTAA would eliminate barriers throughout the Western Hemisphere, creating the world's largest free trade area—a market of 34 countries and 800 million people. The Western Hemisphere already accounts for nearly one out of every two dollars of all our exports. Most of this goes to Canada and Mexico, for the North American Free Trade Area (NAFTA) has generated a huge trade boom. We believe the FTAA will do the same for trade with Central and South America.

Last year, U.S. firms exported $60 billion to Central and South America, an amount four times as much as we exported to China. The market is only a fraction of what it could be. Trade barriers have been holding back both our exports and the region's economic growth. This does not just affect large firms. In fact, of the 46,000 U.S. companies that export to Central or South America, 42,000—91 percent of the total—are small and medium-sized firms.

Based on our experience with NAFTA, the NAM predicts that with the successful negotiation and implementation of the FTAA, our present $60 billion of annual merchandise exports to Central and South America would more than triple within a decade to nearly $200 billion. That would represent a very considerable increase in U.S. industrial production, generating more high-paying jobs in America's factories. America's agricultural and services exports would also grow proportionately.

America is already a very open market. The FTAA would open markets for U.S. products in the rest of the hemisphere. Last year, the average import duty paid on all imports into the United States was only 1.6 percent. That is not a trade barrier; it is barely a speed bump. Moreover, two-thirds of all our merchandise imports from the world last year paid no duty at all. They entered the United States duty-free.

American exporters to South America, unfortunately, face a different situation. There, duties in major markets average 14 percent or more, and it is not uncommon for U.S. manufactured goods to face duties of 20 percent to 30 percent or higher. For example, as one of our members, the 3M company, recently testified, Colombia assesses a 20-percent duty on its U.S.-made electrical tape. Ecuador charges its filter products a 30-percent duty. And so it goes. Those are serious barriers.

There is a real urgency to negotiating the FTAA, for the European Union (EU) is also negotiating free-trade agreements with key South American countries. This is no trivial matter, for the European Union currently sells about as much to South America as we do. The consequences for U.S. exports would be severe if the EU were to obtain duty-free access to these markets while U.S. exports continued to face duties that could be 20 percent or 30 percent. A huge shift away from U.S. products to European products would result. The latest development is that Japan is now exploring the possibility of free-trade agreements with South American countries.

Trade Promotion Authority (TPA)

The one absolutely essential pre-requisite to FTAA is providing the President with Trade Promotion Authority (TPA). Our trading partners insist on having the assurance that what they negotiate with the United States will be voted on as a single package. They will not negotiate under circumstances in which the final deal turns out not to be final, but is one which Congress modifies.

It must be stated bluntly: Without Trade Promotion Authority, the FTAA negotiations simply will not move forward. The same can be said for prospective negotiations on a new round in the WTO. The Latin business communities and government officials with whom we have met were all unanimous on that point: no TPA, no negotiations.

Regrettably, some would applaud if there were to be no negotiations; but maintenance of the status quo means that we lose. Allowing Latin nations to keep their duties of 20 percent to 30 percent on major U.S. exports while we keep our 1.6 percent tariff speed bump against theirs is not a winning solution for the United States.

The time has come to stop negotiating with ourselves and to start negotiating with our trading partners. In particular, the issue of how to handle labor and environmental concerns has stalled us for too long. We must find a way to move forward, for the cost of continued inaction is about to get very expensive. How ironic it would be if we continued to debate labor rights in other countries while thousands of American workers began to lose their jobs as our foreign competitors completed trade deals with Latin America and took our export business away.

The Overvalued Dollar

At current levels, the exchange value of the dollar is having a strong negative impact on manufacturing exports, production and employment. A growing number of American factory workers are now being laid off, principally because the dollar is pricing our products out of markets—both at home and overseas.

Since early 1997, the dollar has appreciated by 27 percent against the currencies of our trading partners. Industries such as aircraft; motor vehicles and parts; machine tools and consumer goods producers are suffering. No amount of cost cutting can offset a nearly 30-percent markup.

The overvaluation is deepening the current downturn in manufacturing. Faced with stagnant domestic demand, due in large part to the inventory correction taking place in the economy, manufacturers are unable to turn to foreign markets to take up the slack, primarily because of the high value of the dollar. Merchandise exports fell by 10 percent during last quarter of 2000 and 5 percent for the first quarter this year.

This is why the NAM, along with the Association for Manufacturing Technology, the Aerospace Industries Association, the Automotive Trade Policy Council, the American Forest and Paper Association, and the Motor Equipment Manufacturers Association, sent Treasury Secretary Paul O'Neill a letter on June 4 requesting the Treasury clarify its dollar policy to be certain that it is not seen as endorsing an even stronger dollar irrespective of the economic fundamentals (to view this letter visit www.nam.org.)

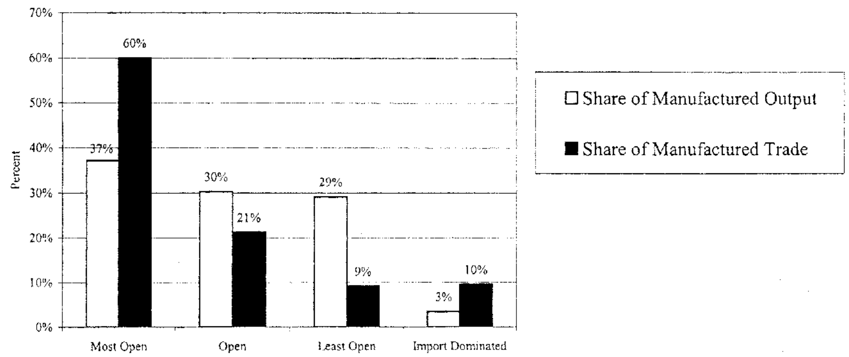
CONCLUSION

Succeeding in the global marketplace not only means seeking out new markets for sales, but also tapping into the global supply chain. By introducing competition from abroad, imports lower costs to U.S. companies. This directly increases America's competitive edge in the global marketplace. A greater competitive edge, in turn, expands our nation's industrial base by creating new global opportunities; since the mid–1980s, the share of U.S. manufactured goods destined for markets overseas has increased from less than 7 percent to more than 14 percent. Over the same period, America's share of world exports has increased by 20 percent.

The evidence from the 1990s is unambiguously clear: the manufacturing industries that have been the *most trade-engaged* have thrived both in terms of growth in output and worker compensation.

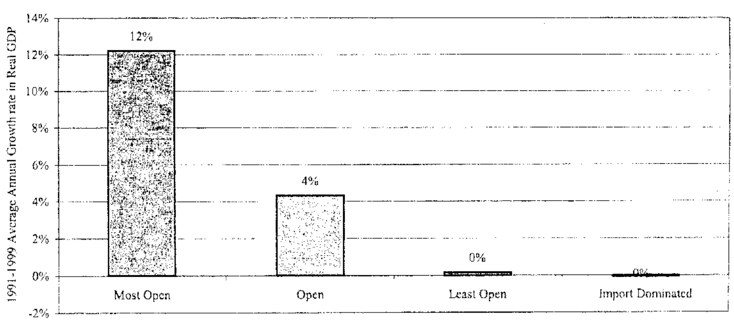
Attachments

Chart 1: Economic Output and Trade Engagement in Manufacturing, 1999



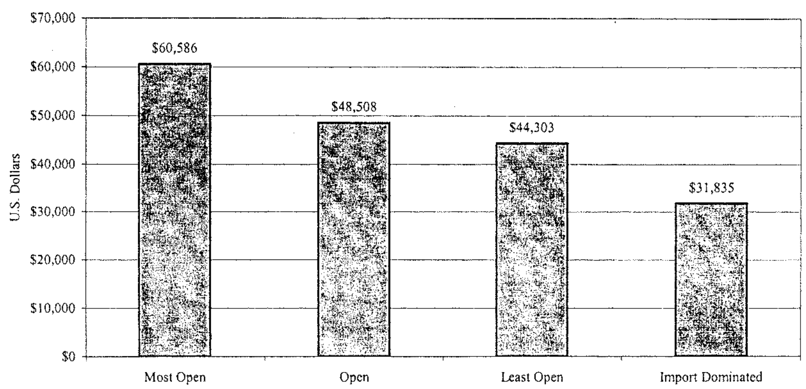
Source: NAM from Commerce

Chart 2: 1991-1999 Growth in Manufacturing Real GDP



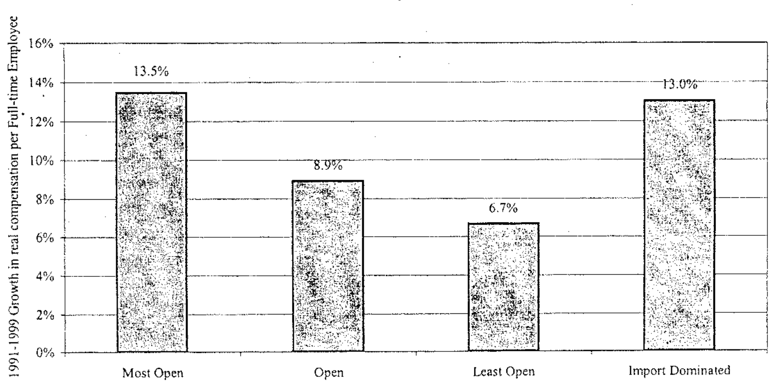
Source: NAM from Commerce Department Data

Chart 3: 1999 Average Compensation per Full-Time Employee



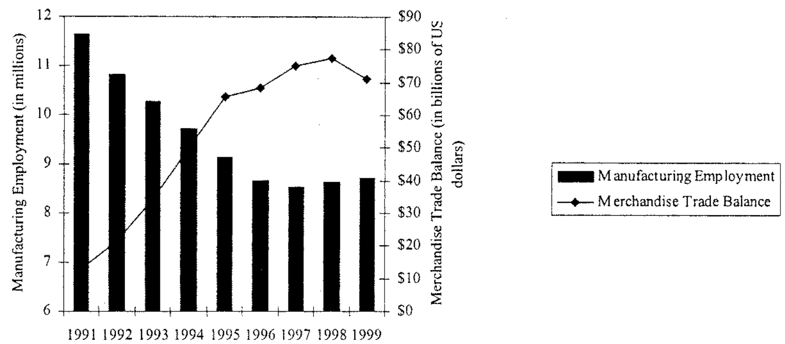
Source: NAM from Commerce Department data

Chart 4: 1991-1999 Growth in Manufacturing Real Compensation per FTE Employee



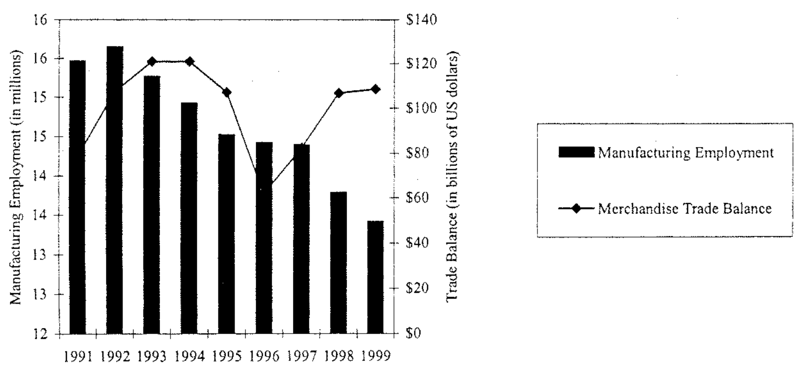
Source: NAM from Commerce Department data

Chart 5: German Manufacturing Employment and the Trade Balance



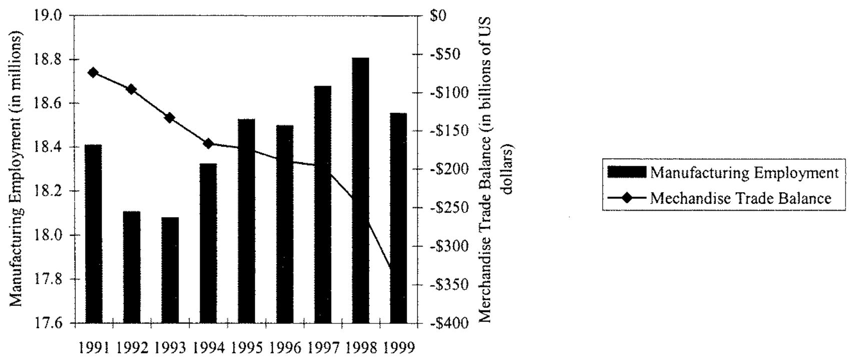
Source: NAM from Labor Department and International Monetary Fund data

Chart 6: Japanese Manufacturing Employment and the Trade Balance



Source: NAM from Labor Department and International Monetary Fund data

Chart 7: U.S. Manufacturing Employment and the Trade Balance



Source: NAM form Labor Department and International Monetary

The CHAIRMAN. Let me thank you. Have you got the time?

Mr. JASINOWSKI. Yes, I have the time, Mr. Chairman, to have you go through the others.

The CHAIRMAN. Oh, very good.

Mr. Faux.

STATEMENT OF JEFF FAUX, PRESIDENT, ECONOMIC POLICY INSTITUTE

Mr. FAUX. Thank you, Mr. Chairman. Thank you especially for starting this hearing on a critically important issue that does not get enough attention in policy discussions today. I also want to thank Senator Dorgan for his leadership in the creation of the trade deficit review commission, which I think has added at least some more information and some more discussion about an issue that we have not talked about enough.

Clearly, Mr. Chairman, something is wrong in the American manufacturing sector. I agree with much of what Jerry Jasinowski just said about U.S. competitiveness. I think American manufacturing has done a great deal over the last decade or so to become more competitive. Still, since March 1998 we have lost about a million jobs in manufacturing. Over the last 10 months we have lost 675,000 jobs. These are high-wage jobs. These are jobs that are important to hundreds of thousands of Americans trying to support their family.

We have a trade deficit in manufacturing that last year went to $390 billion. In the place where I think Dr. Jasinowski and I would part company, I think trade, trade agreements over the last decade have made things worse.

Why is it important? Some would say that over the long run it is not important that we have strong manufacturing in America. I think it is. It is the source of our major productivity gains, the source of the diffusion of innovation throughout the country. Most important, I think, it is the source of upward mobility for millions of Americans who have not graduated from college.

Non-college graduates, I would remind the Committee, make up 73 percent of the U.S. labor force. Manufacturing has been the traditional channel through which those people have been able to enter the middle class and to enjoy a high standard of living.

The problems of manufacturing over the last decade have been obscured to some degree by the domestic boom that we have had. If you can imagine the United States of America as a company with two divisions, one a domestic division that has been doing very, very, very well until recently, making lots of profits, creating jobs; the other a smaller foreign division that in effect has been losing money. Over the last decade we have ignored the second division. Now we find that the domestic boom, especially at the rates of economic growth we enjoyed in the last half of the 1990's, are unsustainable.

The dot.com bubble I think has revealed to us all the weaknesses and the problems in our industrial base. We may be bottoming out, we may not be bottoming out. According to the newspaper story I read this morning, the Fed does not believe that we are bottoming out yet and we will probably have more interest rate cuts when it meets again.

Yet there has been a sublime indifference on the part of this administration and the previous administration to the problems of the trade deficit. Contrast that indifference with the concern that we had over the fiscal deficit. The fiscal deficit issue dominated this town for a decade. We were concerned about leaving our children a mountain of debt. We resolved that problem to the point where the Federal Government politically cannot even borrow money today in order to finance infrastructure.

Arguably, the foreign debt of the Nation that is piling up is an even greater problem. The fiscal deficit was owed to ourselves. The deficit we are creating by financing our imports is owed to overseas investors. You cannot forever borrow money in order to buy more than you are selling. To avoid a financial collapse, sooner or later we either have to buy less, which means a prolonged recession or depression in this country, or we have to sell more.

Here is the core of the problem. In order to sell more, we have to have an expanding manufacturing sector. Yet we continue this madcap rush into signing trade treaties that weaken manufacturing and thus our ability to return our trade to balance.

Therefore, Mr. Chairman, I suggest that we need a strategic pause in our rush to sign more trade agreements. We need to examine the actual experience of the impact of trade on the manufacturing sector. The last administration signed over 200 trade agreements. We have not evaluated them. What are the costs? What are the benefits? The policy debate today is still focused on ideology and assertions despite the fact that we have this experience. I think we ought to have this pause and consider new policies to promote manufacturing, as well as to reduce the overvalued dollar.

I think we have a fundamental problem here. We have cut rates five times over the last year and we still have a dollar that is too high. I also think we need to add labor and environmental standards to our trade agreements.

Finally, I think we ought to consider reorganizing our trade bureaucracy to make it less about deal-making and more about using trade as an instrument to further the economic policies of this country.

Meanwhile, we need relief for key industries, such as steel. The steel industry has downsized, restructured, and become the most competitive steel industry in the world. Still it was devastated by steel imports. Somewhere between one-third and two-thirds of steel-making capacity is now in bankruptcy, Mr. Chairman.

So the central problem of manufacturing in this country is that the trade deficit is out of control. No one knows when the day of reckoning will come, but it will come, and it will leave the next generation high levels of debt and a steadily diminishing capacity to produce the tradable goods that we need to export in order to pay that debt down.

Thank you.

[The prepared statement of Mr. Faux follows:]

PREPARED STATEMENT OF JEFF FAUX, PRESIDENT, ECONOMIC POLICY INSTITUTE

TRADE AND MANUFACTURING

Over the last 10 months employment in U.S. manufacturing has shrunk by 675,000 jobs. If this were simply the temporary result of a business cycle downturn, it would be a serious problem.

But as Figure 1 shows, job loss in manufacturing is a trend of two decades. It reflects the deterioration in the American industrial base, which has now reached crisis proportions.

Why does it matter? For several reasons:

- Manufacturing is the overwhelming source of productivity improvements and technological innovation in the U.S. economy. If manufacturing were removed from the national productivity numbers, America would be left with a largely stagnant economy.
- Manufacturing is the traditional ladder of upward mobility for non-college graduates, who still make up the majority of U.S. workers. It provides the high wage jobs that can lift people into the middle class. It is also a traditional means for immigrants to assimilate into the economy.
- It is critical for the diffusion of innovation. Without a healthy steel industry, for example, the U.S. auto and aerospace industries would be laggards in the competitive race to produce new products with the next generation of HW lightweight metals.
- A strong industrial base has been essential for national defense throughout history.

There is, of course, a tendency in most advanced countries for manufacturing to decline as a *share* of total employment over the long term. This is largely a result of the higher productivity rates in manufacturing relative to the service and commercial sectors. But there is no immutable evolutionary economic law that predicts the *absolute* decline in manufacturing jobs that we see in America today.

A major reason for that absolute decline can be observed in Figure 2, which shows America's current account deficit and the trade deficit in manufacturing goods. It mirrors the decline in manufacturing employment over the last two decades. The crisis in manufacturing is directly related to the long-term erosion of the U.S. trade balance.

But the debate over trade policy still reflects the triumph of ideology over experience. The facts are clear: the trade deficit has done major damage to the industrial core of the economy. And it is common sense that a Nation cannot forever continue to buy more than it sells in the global market. Yet U.S. policymakers from both parties remain sublimely indifferent to America's trade deficit and corresponding deficit on the current account, which in 2000 was 4.4 percent of GDP.

To a large extent, the problem of the trade deficit has been hidden in recent years by the remarkable growth of the domestic U.S. economy since 1992. Imagine that the U.S. economy is a company with two divisions—a large "domestic" division and a smaller "foreign" one. During most of the 1990's, the domestic division was extremely profitable, obscuring the fact that the foreign division was losing money. Table 1 illustrates the point. From 1992 to 2000, real gross domestic product grew by $2.4 trillion, adding 23 million jobs to the economy. But a continued deficit in the international sector of the economy cost 3.8 million jobs.

As long as the U.S. domestic economy grows rapidly, many have argued, workers who lost their jobs as a result of the trade deficit will be rehired in the domestic-oriented economy. However, such transitions are not easy for real people dealing with the real world. In fact, even in boom times, the average worker laid off in manufacturing did not obtain a new job comparable in wages and benefits to his or her old one.

We now know that the extraordinarily high rate of domestic growth in the last half of the 1990's—driven in large part by a speculative bubble in the stock market—was unsustainable. The unemployment rate has been on a rising trend since last October. Despite a minor dip in May 2001, an overwhelming majority of forecasters expect it to continue to increase in the coming months, revealing the ongoing crisis in our industrial sector.

Figure 3 shows the 12 sectors that accounted for almost 90 percent of the trade deficit last year. Led by autos and parts, 10 of the 12 are manufacturing industries, and the other 3 two represent oil, natural gas, and petroleum products. The "new economy" sectors of audio and video equipment, semi-conductors, computers, and communications equipment are among the "losers" from U.S. foreign trade.

Table 2 shows the major countries with whom America is running trade deficits. The huge and rapidly growing deficit with China is particularly troublesome, in light of the eagerness of this Administration, like the last one, to enlarge our trade with that nation. The North American Free Trade Agreement and the Free Trade Agreement with Canada were both sold to the Congress as a way of *reducing* the U.S. trade deficit. Instead the opposite happened; trade deficits with both economies grew. In the case of NAFTA, it was specifically argued that the trade deal would result in a massive U.S. surplus because of all the autos Detroit would sell to Mexican consumers. Instead, U.S. companies outsourced to Mexico to take advantage of cheaper labor and sold cars and parts back here.

The impact of the trade deficit on American workers surpasses the issue of jobs. As Figure 4 shows, the long-term stagnation in workers' earnings stems from the mid-1970's—the time when America's trade balance in goods began to go into chronic deficit.

Trade deficits are not the only contributors to the real wage difficulties of U.S. workers. Conventional models of wage behavior show that imports account for about 20–25 percent of the wage decline. However, these same models can only identify specific causes for about half of the decline in real wages. Thus, the trade deficit probably accounts for at least 40 percent of the identifiable causes.

Moreover, there is ample evidence that trade deficits are having negative effects on wages unnoticed by standard economic models. Kate Broffenbrenner, a Cornell University economist, has shown how NAFTA has given credibility to employer threats that their firms would close down and move to Mexico if employees voted for a union to improve their wages and benefits.

It is also important to note that the evidence to date supports the claim that the current type of trade agreements have encouraged a "race to the bottom" as far as wages are concerned. For example, a recent study, NAFTA at Seven, written by economists from Canada, Mexico and the United States showed that deregulation has pushed down wage levels in all three countries. I would like to submit that study for the record.[1]

In assessing the relationship of the trade balance and manufacturing, I would also call your attention to Figure 5. Trade deficits do not come free. In order to finance them, the United States must either borrow money or sell our assets. The net U.S. foreign debt represents the transfer of claims on U.S. wealth with which we are financing the deficit. As a result of accumulated trade deficits, the debt is now close to 20 percent of GDP. Unless the current trade deficit trend is reversed, this figure will grow relentlessly, and could easily reach 60 percent of GDP in another 8 years.

So far, the use of the U.S. dollar as reserve currency for the rest of the world and the sense that the United States is a safe haven in a volatile global market have protected the United States from a precipitous decline in the dollar's value. Such a decline could set off a financial crisis that would dwarf the 1997 Asia currency debacle. But the debt sword of Damocles is hanging by a thinner and thinner string. The United States cannot borrow and sell assets forever. Eventually, the United States will be forced to run a trade surplus, or face a Depression-level shrinkage in the economy. In order to run a surplus, the United States will need a strong—and much larger—manufacturing base. Yet, this administration—like the last one—is indifferent to both the piling up of foreign debt and the eroding of manufacturing.

Contrast the attitude toward the foreign *trade* deficit with the national anxiety over the government's *fiscal* deficit. When the Federal deficit reached the vicinity of 4 percent of GDP a decade ago, there was much handwringing and national panic over the debt that might be left for the next generations. The concern became so

[1] Material is supplied in the Appendix section.

strong that it has now become politically impossible for the U.S. Government to borrow money to make capital investments in infrastructure. However, the danger of the foreign current account deficit is arguably greater. By and large, Federal deficits are owed to ourselves. In contrast, and by definition, the dollar liabilities generated by the trade deficit represent foreign claims on American incomes, which will be much more painful for our children to pay. Absent a large and healthy manufacturing base, they will not be able to do it without a dramatic drop in their living standards.

Causes of the trade deficit problem

Temporary factors. In the last few years, the chronic trade deficit has been worsened by two factors. First, and most recently, oil and natural gas prices have increased, which has raised the cost of energy imports. Second, there has been faster growth in demand in the United States relative to its major trading partners, particularly after 1997, when the Asia currency crisis slowed down the demand for U.S. exports and led to a large inflow of short-term capital that financed a faster growth in demand for imports.

Fundamental problems. The trade deficit has been growing for two decades, a time that has included periods of low oil prices and periods of slower relative U.S. growth. The more basic causes of a chronic long-term imbalance are largely due to the following:

Shortsighted trade policies. During the Cold War, trade policy was largely an extension of foreign policy. Pieces of the lucrative U.S. market were parceled out or withheld from foreign countries as a carrot or stick to gain allies against the Soviet Union and its communist allies. After the end of the Soviet Union, the deregulation of trade became an end unto itself, rather than a means to achieve U.S. prosperity. Rationalized by the illusion that free trade amounted to a free lunch, successive U.S. governments have led the Nation into trade agreements that have reflected the interests of multinational investors at the expense of companies that produce in the United States and their workers and families. As a result, many of the so-called “free trade” agreements, such as NAFTA, are as much or more concerned with protecting investment as they are with trade.

Lack of manufacturing policy. Unlike most other nations, the United States has no active policy to preserve its manufacturing base. Since trade largely involves the industrial sector, there is no policy framework to guide the deals made by the U.S. trade negotiators. The result is that American trade negotiators have a tendency to see expanded trade—whether imports or exports—as an end unto itself, rather than as a means to a healthy American economy.

Lack of international labor and environmental standards. All advanced modern economies contain enforceable rules for the protection of labor and human rights and the maintenance of environmental standards. These economic rights assure that the benefits of economic growth will be widely shared and that growth will not jeopardize the air we breathe and the water we drink. But the global economy has no such protections. This has encouraged multinational corporations to shift production to locations in the Third World where labor and human rights and environmental standards either do not exist or are not enforced. This puts U.S. workers at a disadvantage and prevents development in the Third World from raising wages there.

Foreign protectionism. For all the complaints about U.S. protectionism, the U.S. market is far more open than the domestic markets of its trading partners. The much greater transparency of the U.S. legal and political system puts America at a disadvantage relative to the European Union and Japan, whose economies are laced with formal and informal non-tariff barriers to U.S. goods.

Overvalued dollar. Normally, a national economy adjusts to a prolonged trade deficit by having its currency decline in value, making its exports more expensive and its imports cheaper. The U.S. dollar has not fallen in order to allow that adjustment to take place. One reason is the policy of the U.S. Government to resist a drop in the dollar’s value. This bias favors U.S. investors in foreign nations—whose interest is to have a more valuable dollar—over U.S. producers in America, who need a lower dollar in order to expand exports. Estimates vary, but currently the U.S. dollar is overvalued by at least 25 percent, and possibly as much as 40 percent.

Low savings. A low savings rate means a reliance on foreign sources of investment. Ultimately, net financial inflows create spending on foreign goods and services. Low savings also means high consumption. As a result of these factors, American consumers have an extraordinary high marginal propensity to consume imports. Currently, however fast the U.S. economy might grow, imports grow faster.

POLICY CONSIDERATIONS

The crisis in manufacturing employment will not be resolved by a single policy bullet. It will require a range of policy solutions, guided by an understanding of the fundamental causes of the problem. The process must start with a commitment to restoring and maintaining the U.S. industrial base.

The basic issue is not how to placate a politically important industry or constituency. Instead, America needs to ask if it wants to have an industrial base 10–20 years from now. If so, how does the United States assure that it will have one?

It has been a long time since the United States asked itself such strategic questions about the economy. In fact, the United States has largely abandoned the institutions and habits of thought that are involved in coming up with answers.

Therefore, if America is serious, it needs to provide the time necessary for a meaningful policy debate. To give us that time, I suggest that we need:

- *A "strategic pause"* in the relentless pursuit of trade agreements, such as another World Trade Organization (WTO) round or the proposed extension of NAFTA to the rest of the Western Hemisphere in a so-called Free Trade Area of the Americas. In the last decade alone, the United States has signed over 200 trade agreements, yet done virtually no serious evaluation of their impact. Despite this real life experience, the debate over trade and globalization in America is still as dominated by ideology, assertions, and theorizing as it was two decades ago. It is time to find out what we have learned and debate its implications.
- Meaningful short-term efforts to protect industries such as steel are now faced with virtual extinction as a result of the destructive trade policies of the last two decades. Without such efforts, there will be little industrial base to preserve.

In terms of specific policies that might help halt and even reverse the erosion of the U.S. manufacturing base, I recommend a national commitment to strengthening the manufacturing sector in the U.S. economy to include:

- Increased research and development subsidies;
- Creation of a capital pool for small- and medium-sized U.S. manufacturers; and
- Large increases in technical training and career-long education for American workers.

The CHAIRMAN. Thank you very much.

Mr. Baker.

STATEMENT OF DEAN BAKER, CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH

Mr. BAKER. Thank you very much, Mr. Chairman. I am going to have a bit of a slide show here, so sorry for the delay.

I want to make two main points in my testimony here, both of which I realize you are well aware of, but I think deserve emphasis: first, that we have an overvalued dollar and that is, at least at the moment, the core of the problem with the trade deficit; and second, that this is unsustainable, that we have a trade deficit that clearly cannot go on at this pace for more than a very short period of time, 2 or 3 years.

Just to repeat some of the basic facts. These have already been said very well by Jeff and Jerry Jasinowski, but just to remind everyone: In the last 3 years we have lost a million jobs in manufacturing. This has been strongly associated with the trade deficit. If we go back to the fourth quarter of 1997, the trade deficit was about $90 billion or about 1.1 percent of GDP. The last quarter of 2000 the trade deficit was at about $400 billion I believe, or about 4 percent of GDP.

This also corresponds very directly to the fall in the dollar. If we look at one of the Federal Reserve Board's broadest indexes, the dollar in real terms has fallen by about 20 percent from the value it was at in the summer of 1997 before the east Asian financial crisis. So these go very, very clearly together.

Now, just to make the basic points, if I could have Rob put this up. Again, I realize this is not new to you, but I just think it is really dramatic. It is certainly dramatic to me just to look at these numbers, very, very simple numbers. Just a hypothetical case, let us say that we have a foreign producer of steel that it would cost them $220 a ton to sell it here and we have a domestic producer selling at $200 a ton. In other words, our producers are about 10 percent more efficient in steel. I said this is the normal dollar case.

Let us just flip that over and let us imagine we have seen the fall of the dollar, or I should say the rise in the dollar, that we have actually seen over the last 3½ years. Suddenly the foreign producers are selling their steel for $176 a ton. Our producers, as we saw a moment ago, were 10 percent more efficient. Suddenly they are costing $24 more per ton of steel.

Now, I submit to you that there is virtually no way that a producer can compete in that sort of context, and the facts that Jeff was just presenting, that is what happens when you see a situation where we are in effect giving a subsidy on the order of $44 a ton of steel to every foreign producer. This would be the exact same thing—we could take it from either end—a foreign government subsidizing their exports to the United States or, if you like it our side, we are subsidizing imports. So this has corresponded to the decline not only in the steel industry, but throughout the manufacturing industry.

Let me just make one other point. Jeff did make this point, but I just want to emphasize it. We are really talking about this occurring, not today but say 6 months ago, a year ago, in the best of economic times. As we know, we had 4 percent unemployment through the year 2000, the lowest unemployment rate we had had since the late sixties.

But if we looked at the Labor Department's worker displacement survey that was taken that year, looking at people who had lost their jobs within at least 6 months ago, what we found is that over 25 percent, 26.5 percent of those workers, were either unemployed or out of the labor force altogether and only 43 percent of these workers were able to find jobs that paid a comparable amount or more.

To me that is a very, very striking figure. So what we are saying is when we are seeing this sort of increase in the trade deficit and this sort of job loss even in the best of times, these workers are not finding jobs in many cases and even when they do find jobs the overwhelming majority are finding jobs that pay much less than the ones they lost. So that is what we can say in the best of times. Who knows how low the economy is going to go right now, but we are no longer in the best of times.

The second point I wanted to make is this is unsustainable. Here the arithmetic is fairly straightforward. Again, I will just refer to the points Jeff had made. We had become very concerned about the budget deficit. We could argue whether it was overly concerned or not, but on the basic facts the trade deficit is very comparable to a budget deficit. I would just ask, what would we be saying in this town if we had a budget deficit this year of $450 billion? In effect, that is what we are borrowing from abroad. The broader measure of the current account deficit last year in the fourth quarter was about $450 billion.

Now, I would not want to have anyone be too scared of that. We are a $10 trillion economy. We could run a budget deficit of $450 billion for a year, 2 years, 3 years. We could do the same thing with the trade deficit. But just as we know with the budget deficit that would not be sustainable, the same story with the trade deficit.

If we could get the next slide, I just carried through some of the arithmetic. I just said let us see what happens if we continue to have a trade deficit at the current level, roughly 4 percent of GDP; what will happen to our net foreign indebtedness? Again, I realize this is nothing new for the members of the Committee, but it was striking to me at least just to put it down on paper and just take a look at this.

What we would see is that by the year 2010 our net foreign debt would be up to about $10.6 trillion. That is a lot of money. In 2020 we are up to $32.5 trillion, and if we continue to pursue this policy, if we continue to have trade deficits of 4 percent a year out to the year 2030, we would be looking at trade deficits—I am sorry, foreign debt, net foreign indebtedness, of $90 trillion.

Now, to give a more meaningful number, let me get the last slide. To put as a share of GDP, we are starting out at the end of 2001. Given our current path, we are going to be looking at foreign debt on the order of about 20 percent of GDP. That puts us right near the top. Canada and Australia also have very high foreign indebtedness as a share of GDP, but we are right near the very top.

If we carry it out to 2007 we are looking at foreign indebtedness of 50 percent of GDP, way above any other industrialized nation. If we continue on this path as far as 2017, that is the point at which foreign indebtedness will pass, will be more than 100 percent of GDP. Carry it out to 2032, 200 percent of GDP. Carry it out to 2050, it would be over 400 percent of GDP.

Now, I do not mean to suggest we are going to follow this path. We will not follow this path. We all know it is unsustainable. We cannot follow it, just as when CBO does these projections of the debt going through the roof we are not going to follow those paths. Everyone knows that. Everyone knows we will not follow these paths.

But the point is that we are building up debt and it becomes harder and harder to get off this path the longer we wait. The analogy I like to use is right now the high dollar is in effect comparable to giving us a credit card where all our foreign purchases are subsidized by 20 percent through that credit card, and everything feels really good when you can get those goods at 20 percent off. But we all know at the end of the day we are going to have to pay the bill.

To me it is a very strong case to be made that we should be dealing with this issue now. We should be trying to get the dollar down to more normal level, get the trade deficit down to a more normal level, so that we do not pass this huge debt to our children.

One last point I just want to make in terms of the context of future legislation, future trade agreements. I would like to make a plea for a little honesty in this debate. I was really struck at the end of the negotiations or the debate over the PNTR for China last year that immediately after it passed there was an article in the Washington Post that I referenced in my testimony, there were similar articles in the New York Times, Wall Street Journal, all across the media, after PNTR was passed, that this was really about investment, not about trade.

That is exactly right. We are not going to be major exporters of steel, of cars, of these other items to Mexico, to China, to the rest of Latin America. It just does not make sense. I am an economist. I know very well the arguments as to why these trade agreements have gains. They do have some gains, no doubt about it.

But we should try and have arguments that are based on the reality. This is about investment, it is about facilitating the ability of U.S. firms to invest in Mexico in the case of NAFTA, invest in China in the case of PNTR, or invest in the rest of Latin America if we extend that Free Trade of the Americans Agreement.

So I would hope that as this goes forward we could have the debate take place on the merits of what actually will take place and not a fictitious situation.

Thank you very much.

[The prepared statement of Mr. Baker follows:]

PREPARED STATEMENT OF DEAN BAKER, CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH

I appreciate the opportunity to address the Senate Commerce Committee about the problems created by the strong dollar and the current trade deficit. In the last 3 years U.S. manufacturing has lost 1 million jobs. During this time the trade deficit has soared from less than $90 billion in 1997, 1.1 percent of GDP, to more than $400 billion in the last quarter of 2000, or 4.0 percent of GDP. This loss of jobs has not only had a devastating impact on the workers directly affected[1], but it is also creating serious long-run problems for the economy as a whole. The trade deficit is causing the United States to borrow money from abroad at an annual rate of more than $450 billion a year. This is no more sustainable than a budget deficit of $450 billion. The immediate cause of this huge deficit is the high dollar, which effectively subsidizes the purchase of imports. It is important to understand how the high dollar hurts domestic production and why the current situation is unsustainable.

The exchange rate between the dollar and other currencies effectively determines the relative price of foreign and domestic goods. When the dollar rises in value relative to other currencies, all goods produced in the United States become more expensive relative to foreign goods, or to put it another, way foreign goods become cheaper for people living in the United States. For example, if the dollar rises by 20 percent against the British Pound, then goods produced in Britain suddenly become 20 percent cheaper for people in the United States, whereas goods produced in the United States become 20 percent more expensive for people in Britain.

This is essentially what has happened in the last four years. The East Asian financial crisis caused the currencies of the region to plummet in value against all major world currencies. Because of the relative strength and stability of the U.S. economy, many investors put their assets in the United States, causing the dollar to rise against other major currencies, as well. As a result, the dollar has risen by approximately 20 percent against the currencies of its trading partners since the middle of 1997.[2] This rise in the dollar has made U.S. goods approximately 20 percent more expensive relative to the goods produced by our trading partners.

Figures 1a and 1b show how this impacts U.S. goods. They show the cost to consumers in the United States of a ton of steel produced domestically compared to the cost of a ton of steel produced abroad in both a normal dollar scenario and a strong

[1] According the Labor Department's 2000 Worker Displacement Survey 26.5 percent of the long-tenured workers who lost their jobs in the period 1997–1999 were either unemployed or out of the workforce altogether. Only 43 percent of these workers were able to find jobs that paid comparable or higher wages.

[2] This calculation is based on the real value of the dollar measured by the Federal Reserve Board's OITP currency index.

dollar scenario. As can be seen, the rise in the dollar lowers the price of the foreign produced steel relative to the price of steel produced in the United States. In this example, a ton of foreign steel which would have cost $220 before the drop in the dollar now costs U.S. consumers just $176 as a result of the rise in the dollar. This means that if U.S. producers could produce steel profitable at $200 per ton, the rise in the dollar created a situation in which they are no longer competitive. Instead of underselling the foreign competition by $20 per ton, the costs of U.S. producers are now $24 per ton higher than the price of the foreign steel.

This describes the situation that has devastated much of U.S. manufacturing in the last four years. The high dollar has also contributed to the nation's farm problems through the exact same mechanism. As a result of the high dollar, foreign agricultural products appear far cheaper to U.S. consumers and U.S. agricultural products are far more expensive to consumers overseas. The high dollar has the same impact on our agricultural products as if the United States subsidized all imported items by 20 percent, and every other nation imposed a 20 percent tariff on imports from the United States.

There are some short-term benefits to a high dollar since it effectively allows us to buy foreign goods at below their true cost. This helps keep inflation down and allows the nation to consume more than it is producing. But this effect is only short-term. The only way that the United States can pay for these imports is through foreign borrowing, and this clearly has its limits. It is possible for a nation like the United States, with a $10 trillion economy, to borrow $450 billion for a year or two, but it cannot do so indefinitely.

Figure 2a shows the growth of the foreign debt of the United States assuming that it continues to run a trade deficit equal to 4.0 percent of GDP, as it did in the fourth quarter of 2000. By 2010, the foreign debt will be $10.6 trillion. By 2020, the debt will be $32.5 trillion. If the current trade deficits persist for 30 years, the foreign debt will be more than $90 trillion.[3] If the trade deficit remains at its current size relative to the economy for 50 years, then the foreign debt will exceed $400 trillion.

Figure 2b shows the same information, but expressed as a percentage of GDP, which is a more meaningful figure. The foreign debt is already approaching 20 percent of GDP, which places us near the top of the industrialized world. If current trends continue, the foreign debt will exceed 50 percent of GDP by 2007, a far higher level of indebtedness than any industrialized nation has ever experienced. By 2017, the foreign debt will exceed 100 percent of GDP, a situation only experienced by the most impoverished of developing nations. In 2032 the foreign debt would be more than twice GDP, and nearly four times GDP by 2050.

Of course, the United States will never see its foreign debt reach these levels. The dollar will undoubtedly fall and bring the trade deficit closer to balance long before the foreign debt comes close to the levels shown on these graphs. But the point here should be clear, the situation is unsustainable. The high dollar is causing the nation to live beyond its means. While the short-term effects can be positive—as is the case for a family running up credit card debt—in the long-term, today's trade deficits will leave us with a huge foreign debt to repay.

On a slightly different topic, there is one other point that I want to make on how we think about trade agreements. The proponents of recent pacts such as NAFTA or PNTR for China generally argued their case based on the increased trade that would ensue. Specifically, they held out the promise of increased U.S. exports to the countries affected and the jobs that such exports would create.

After the approval of these agreements it was generally acknowledged that these agreements were about investment, not trade (e.g. see "For Many, China Trade Bill Isn't About Exports," by John Burgess, *Washington Post*, May 27, 2000, page E1). There are legitimate grounds for differing opinions on the merits of the various commercial agreements that have come before Congress in the past, and which will be presented to it in the near future. However, the public will benefit far more if the debate is conducted in an honest manner. The notion that that the United States will ever export on a large scale products like steel or automobiles to China or Mexico, as was argued by the proponents of PNTR, is ridiculous on its face. If the proponents of these agreements really believe that they advance the public good, then they should be prepared to tell the nation why an agreement that promotes U.S. investment in China, Mexico, or elsewhere in the developing world will help the nation as a whole. If they can't make this case, then they must not believe that these agreements really benefit the nation as a whole.

[3] These calculations assume that the trade deficit remains at 4 percent of GDP, real GDP grows at 3.0 percent annually, and that the real rate of interest on foreign debt is 4.0 percent.

The CHAIRMAN. Well, thank you very much.
Mr. Griswold.

STATEMENT OF DANIEL T. GRISWOLD, ASSOCIATE DIRECTOR, CENTER FOR TRADE POLICY STUDIES, CATO INSTITUTE

Mr. GRISWOLD. Chairman Hollings, Senator Dorgan: Thank you for allowing the Cato Institute to testify today on the state of U.S. manufacturing. We can all agree that manufacturing is an important sector and that the last 9 months have been a rough patch. I suspect the real debate, and I think we have heard it already this morning, lies in what has caused the slump and what Congress should do about it.

The temptation will be strong to blame foreign competition for the recent decline in manufacturing output, but that would be a serious mistake. In fact, U.S. manufacturing has prospered during much of the past decade, a period not only of rising manufacturing output but of rising imports and rising trade deficits.

The cause of the recent downturn is not a flood of imports or a giant sucking sound of U.S. investment going overseas. The cause is much closer to home—a slowdown in domestic demand. Manufacturing has been hit by the same one-two punch of high interest rates and rising energy costs that has staggered the rest of the economy. The slowdown in demand has caused inventories to accumulate and production to fall. Adding to the pain, of course, has been an appreciating dollar and sluggish growth in export markets. In short, the problem for manufacturing is not too much trade, but not enough growth.

As you consider the current state of U.S. manufacturing, allow me to make four brief points. First, the recent slump should be seen in perspective. Until the second half of 2000, the U.S. manufacturing sector was enjoying an almost decade-long boom. Total domestic manufacturing output rose by 55 percent from 1992 to its peak last year. Domestic output of durable goods during that same time almost doubled. Although output has fallen in the last 9 months, it remains almost 50 percent above what it was in 1992.

Figure 1 behind me shows the growth of U.S. industrial production during the past decade and compares it to the growth in other major industrialized countries. The chart illustrates a long stretch of uninterrupted growth of U.S. industrial output, growth that outpaced that of other major economies. This is hardly the profile of a nation that is losing its manufacturing base.

My second point: Imports have not been the cause of the recent slump. Up until last fall, the economic expansion had witnessed both an increase in the volume of imported goods and an increase in domestic manufacturing output. An expanding economy raises demand both for domestic production and for imports. It spurs producers to import more capital goods and intermediate goods, such as auto parts, steel, and computer components. In fact, more than half of U.S. imported goods are not final consumer products, but are inputs and capital machinery that make U.S. businesses more competitive.

As a result, imports tend to rise along with domestic output. Figure 2 behind me shows the strong correlation between manufacturing output and imports. It shows the growth in the volume of imported goods and manufacturing output for each year from 1989 through 2000. If the critics of trade were correct that rising imports have displaced domestic production, then manufacturing output should have declined as the volume of imported goods rose.

But since 1989 manufacturing output has expanded along with import volume, with imports rising fastest during years when imports have grown most rapidly, and manufacturing output has grown the most slowly during years and which imports grew the most slowly. True to form, in the last 9 months as manufacturing output has dropped 3.4 percent the volume of imported goods has dropped 3.2 percent.

It would be unfair to blame rising imports for the manufacturing slump when in fact imports have been falling.

Third point: The recent slump in manufacturing cannot be blamed on an exodus of manufacturing investment to low-cost producers, such as Mexico and China. The giant sucking sound we were supposed to hear never happened. In the years after approval of NAFTA and the Uruguay Round agreements, domestic investment in the United States continued to climb, including investment in manufacturing.

American manufacturing companies have been investing about $2.5 billion a year in Mexico, about $1 billion a year in China. But that amounts to a trickle compared to the flood of manufacturing investment pouring into the United States. From 1997 to 1999 net inflows of direct foreign manufacturing investment to the United States averaged $36 billion a year. I do not need to remind Senator Hollings a lot of that is going to South Carolina. I toured that beautiful BMW plant earlier this year—4,500 jobs. I do not think the people there view that plant as a debt to our children. They view that as a good-paying job, building the future for their families.

Overall, about $200 billion a year is being invested in domestic U.S. manufacturing. American manufacturing FDI that does flow overseas flows overwhelmingly to other high wage, high standard nations.

My final point: It would be a mistake to focus on jobs rather than output as the measure of manufacturing health. Productivity gains in the manufacturing sector have consistently outpaced those in the rest of the economy. We can produce more manufactured goods today than ever before with fewer workers because those workers are so much more productive than in the past.

If Members of Congress are determined to stop any loss of jobs in the manufacturing sector, you would have to legislate, not against imports, but against the capital investment and technological improvements that are fueling the gains in productivity.

Technology, not trade, is the great displacer in the U.S. economy. According to the Bureau of Labor Statistics, there were about 7.5 million Americans who lost their jobs due to layoffs from 1997 to 1999. About 1.8 million, or less than a quarter of those workers, were in manufacturing. The other three-quarters were in wholesaling, retailing, services, financial services, and government. Those workers were not displaced by imports, but by new technologies and changing market conditions.

I will just say one thing about the one million manufacturing jobs that have been lost since March 1998. What we have to keep in mind is up until then, in fact from January 1994, when NAFTA went into effect, until January 1998, the U.S. economy added 700,000 manufacturing jobs, during the first 4 years of NAFTA.

In summary, the recent slump in manufacturing output is not the fault of rising imports or an outflow of capital, but of a general slowdown in the economy. An open and competitive U.S. economy has been a tonic for American industry. International competition has spurred innovation, efficiency, and customer satisfaction. Of course, not all companies thrive in a competitive marketplace, but for the U.S. manufacturing sector as a whole international trade has been a blessing.

Thank you.

[The prepared statement of Mr. Griswold follows:]

PREPARED STATEMENT OF DANIEL T. GRISWOLD, ASSOCIATE DIRECTOR, CENTER FOR TRADE POLICY STUDIES, CATO INSTITUTE

INTRODUCTION

Chairman Hollings and other members of the Commerce Committee, thank you for inviting the Cato Institute to testify today on the state of U.S. manufacturing and the reasons behind the recent slump in manufacturing output. We can all agree that manufacturing is an important component of the U.S. economy and that the past three quarters have been an especially rough period for U.S. manufacturers. I suspect that the real debate lies in what has caused the slump, and what if anything Congress should do about it.

The temptation will be strong to blame foreign competition for the recent decline in manufacturing output, but that would be a serious mistake. In fact, U.S. manufacturing has prospered during much of the past decade, a period not only of rising manufacturing output but also of rising imports and growing trade deficits. The cause of the recent slump in output is not a flood of imports or a "giant sucking sound" of manufacturing investment moving overseas, but a slowdown in domestic demand.

Manufacturing has been hit by the same one-two punch of high interest rates and rising energy prices that has slowed output in the rest of the economy. The slowdown in domestic demand for manufactured goods, by consumers and by business, has caused inventories to accumulate and production to fall. Adding to the manufacturing sector's pain has been an appreciating dollar and sluggish growth in some important markets abroad. The problem for manufacturing has not been too much trade, but not enough domestic growth.

As members of the Commerce Committee consider the current state of U.S. manufacturing, please allow me to make four points:

MANUFACTURING OUTPUT REMAINS NEAR RECORD HIGH

First, the recent slowdown in manufacturing output should be seen in perspective. Up until the second half of 2000, the U.S. manufacturing sector was enjoying an almost-decade-long boom. According to the Federal Reserve Board, total manufacturing output rose by 55 percent between 1992 and September 2000. Domestic output of durable goods during that same period almost doubled. Output of motor vehicles and parts was up 75 percent; output of fabricated metal products, up 36 percent; output of industrial machinery and equipment, up 160 percent; output of electrical machinery, up almost 500 percent. This is not the profile of a nation that is losing its manufacturing base.

Since its peak last September, manufacturing output has declined every month, but total output remains almost 50 percent above what it was in 1992, and remains near its record peak of last year. Figure 1 shows the growth of U.S. industrial production—the total output of U.S. factories, mines, and utilities—during the past decade, and compares it to growth in other major industrialized countries. The chart illustrates a long stretch of uninterrupted growth in industrial output, growth that outpaced growth in the other major economies and our own growth of real GDP. Again, this hardly pictures a nation that is "deindustrializing."

MANUFACTURING OUTPUT AND IMPORTS RISE TOGETHER

Second, the evidence is strong that imports have not been the cause of the recent slump in total manufacturing output. Until the recent slowdown, the economic expansion had been characterized by a simultaneous increase in the volume of imported goods and an increase in domestic manufacturing output. In fact, the growth of real goods imports and manufacturing output tend to be positively correlated. That is, as manufacturing output rises in the United States so too do imports of goods, adjusted for price changes.

The reason for this is simple. An expanding economy raises demand both for imports and for domestic production. Consumers with rising incomes buy more goods, both imported and domestically made. American producers also import more intermediate goods, such as auto parts and computer components, and capital goods. In fact, more than half of U.S. imported goods are not consumer products but are inputs and capital machinery for U.S. businesses. For example, steel imports help keep costs down for a wide swath of U.S. industry, including automobiles and light trucks, fabricated metal products, and construction.

As a result, imports tend to rise along with domestic output. Figure 2 shows the strong connection between manufacturing output and imports. It shows the growth in the volume of imported goods and manufacturing output for each year from 1989 through 2000. If the critics of trade were correct that rising imports have displaced domestic manufacturing output, we would expect manufacturing output to decline as the volume of imported goods rose. But since 1989, manufacturing output has generally expanded along with import volume, with output rising fastest during years in which the growth of real goods imports has also grown fastest. As with so many other economic indicators, the same economic expansion that spurs manufacturing output also attracts more imports and enlarges the trade deficit.

In the last nine months, the trend has cut the opposite way: the 3.4 percent drop in manufacturing output since the second quarter of 2000 has been accompanied by a 3.2 percent drop in real imports of goods.

NO GIANT SUCKING SOUND

Third, the recent slump in manufacturing cannot be blamed on an exodus of manufacturing investment to lower-cost producers such as Mexico and China. The giant sucking sound we were supposed to hear never happened. In the years after congressional approval of NAFTA and the Uruguay Round Agreements Act, domestic investment in the United States continued to climb, including investment in manufacturing.

The predicted flight of capital to countries with lower costs and standards never materialized. In fact, during the past decade the United States has been the world's largest recipient of foreign investment. Year after year the United States has run a net surplus in its capital account, with foreign savers investing more in the United States than American savers sent abroad. This inflow of foreign capital has kept interest rates down, built new factories, and brought new technology and production methods to our economy. If there has been any giant sucking sound since 1993, it has been the rush of global capital to the safe and profitable haven of the United States.

American manufacturers continue to be net investors in Mexico and China, but the relative magnitude of the investments remain small. From 1994 through 1998 the annual net outflow of FDI in manufacturing to Mexico averaged $1.7 billion; the net annual outflow of manufacturing investment to China has been even smaller, averaging less than $1 billion. Those sums are inconsequential in a U.S. economy that averaged almost $8 trillion in annual GDP during the same period, and where annual domestic business investment exceeds $1 trillion. In contrast to the relative trickle of outward investment to Mexico and China, domestic capital expenditures in U.S. manufacturing in 1998 totaled $207.3 billion. In fact, in recent years, the United States has been a net recipient of billions of dollars in manufacturing FDI, much of it from Western Europe and Japan.

The American manufacturing FDI that does flow abroad generally flows to other high-wage, high-standard economies. According to a recent study on global manufacturing investment by the Deloitte and Touche consulting firm, other high-wage countries attracted 87 percent of total U.S. manufacturing FDI outflows in 1999, up from 75 percent in 1998 and 69 percent in 1997. The study explained, "Since only a relatively small percentage of a firm's costs are in wages, factors such as local market size, skill and education levels of the host country workforce, and political and economic stability become much more important for U.S. firms when making investment decisions."

The United States has nothing to fear from openness to trade and investment with less-developed countries. Global trade liberalization promotes investment, growth, and development in the United States as well as our trading partners.

TECHNOLOGY: THE GREAT JOB DISPLACER

Fourth, it would be a mistake to focus on jobs rather than output as the measure of manufacturing health. Productivity gains in the manufacturing sector have consistently outpaced productivity gains in other sectors of the economy. We can produce more manufactured goods today with fewer workers because our manufacturing workers are so much more productive than they were in the past. If members of Congress are determined to stop any loss of jobs in the manufacturing sector, you would have to legislate not against imports, but against the capital investment and technological advances that are fueling the gains in manufacturing productivity.

Technology, not trade, is the great job displacer in the U.S. economy. In the last two decades, tens of thousands of telephone operators, secretaries, and bank tellers have been displaced from their jobs, not by imports, but by computerized switching, voice mail, and automatic teller machines. Further back in American history, entire industries have downsized or disappeared because of changing technology. Employment in the railroad industry plunged in the second half of this century because of competition from domestic airlines, automobiles, and trucks, not from foreign railroads. Employment in the agricultural sector fell steadily for decades, again not because of imports—America has long been a net exporter of food—but because of a mechanical revolution on the farm.

Recent employment data confirm that imports are not the major cause of job displacement. According to the Bureau of Labor Statistics, 7.5 million American workers age 20 and over were “displaced” from their jobs in 1997–99 because work was insufficient, the plant or company where they worked shut down or moved, or their position or shift was abolished. Of all the displaced workers counted by the BLS, 1.8 million, or less than one-quarter, were working in the manufacturing sector when they lost their jobs. The other three-quarters of displaced workers were in the essentially non-tradable wholesale and retail sectors or in other service industries at the time they lost their jobs. Those workers were displaced not by imports, but by new technologies and changing market conditions.

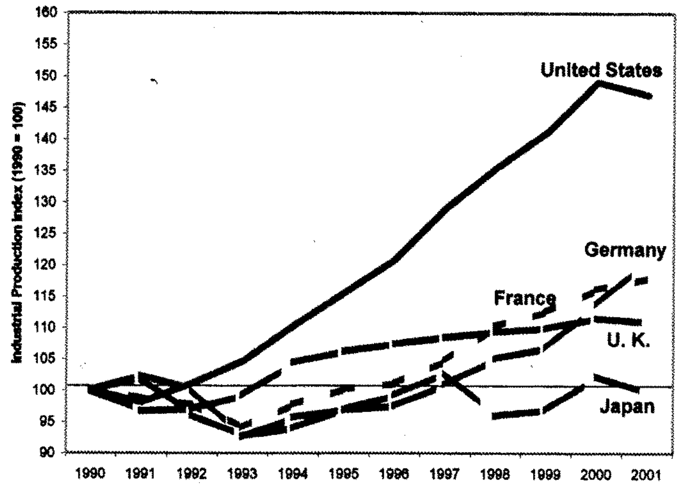
CONCLUSION

In summary, the recent slump in manufacturing output is not the fault of rising imports or an outflow of capital, but of a slowdown in the domestic economy caused by high energy and borrowing costs. Manufacturing output boomed during much of the last decade during a time of steadily rising import volume and trade deficits.

An open and competitive U.S. economy has been a tonic for American industry. International competition has spurred innovation, efficiency, and customer satisfaction. The biggest winners have been American families, who benefit from the lower prices, greater variety, and higher quality of products that international competition makes available. Not all companies thrive in a competitive marketplace, of course, but for the health and vitality of the American manufacturing sector as a whole, not to mention the overall economy, international trade has been a blessing.

Figure 1

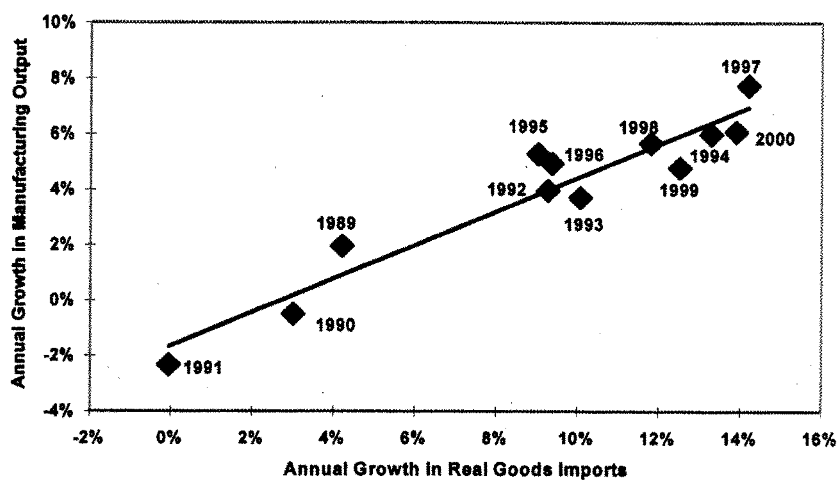
America's Industrial Expansion, 1990-2001



Source: Joint Economic Committee, *Economic Indicators,* May 2001, p. 35.

Figure 2

Goods Imports and Manufacturing Output Grow Together



Sources: U.S. Department of Commerce, Bureau of Economic Analysis, http://www.bea.doc.gov/bea/dn/nipaweb/TableViewFixed.asp;
U.S. Federal Reserve System, http://www.federalreserve.gov/releases/G17/ipdisk/ip.sa.

The CHAIRMAN. Thank you very much, Mr. Griswold.

Let me yield to our colleague. Senator Dorgan has to get to another hearing, but I appreciate his appearance here.

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Mr. Chairman, thank you very much. I have to go to the Energy Committee. Let me say how pleased I am that you are beginning to put a spotlight on some of these trade issues, Mr. Chairman. I think it is long past the time to do that. As many of our witnesses suggested, there is this tendency to ignore this trade deficit, especially the alarming growth in the merchandise trade deficit. There is a tendency to say nothing about it. You do not see any pieces written in the Washington Post much about it. They have an institutional mind set about how things ought to be and they write that. You cannot even have an effective trade debate in this town. But maybe you will light the fuse to start it, and I appreciate your efforts.

Let me just explore just for a moment these issues. Mr. Griswold, your testimony was particularly interesting to me, as I knew it would be. Your proposition I guess is that things are going really, really well and that we just have this temporary slump. We have a relentless march of a merchandise trade deficit that has been moving up and up and up and up. I am not talking about this slump now. I am just talking about a relentless increase in the merchandise trade deficit.

That in part is because we are importing much more than we are exporting in terms of goods. You referred to this giant sucking sound, which is of course the phrase that was used in a campaign about these issues dealing with NAFTA. But many of us take a look at the same situation you look at and see something completely different. The largest imports from Mexico to the United States are what? Would you be able to tell me, what are the largest imports coming from Mexico to the United States?

Mr. GRISWOLD. Probably automobiles and automobile parts.

Senator DORGAN. And electronics, right. Automobiles, automobile parts, and electronics are the three largest imports. Those who supported NAFTA predicted the largest imports coming into the United States would be what, prior to the enactment of NAFTA?

Mr. GRISWOLD. I do not know. I am not in the prediction business.

Senator DORGAN. The product of low-skilled labor. All of them said the product of low-skilled labor will be what we bring into the United States from Mexico. Of course, they were wrong about that, but almost all of the so-called experts have been wrong about almost everything with respect to international trade for a decade or two.

Now, the question today is about the health of the manufacturing sector. I happen to think that the manufacturing sector is the center pole of an economic tent. If you have a manufacturing sector that collapses on you, you are not going to have a world-class economy. It is just that simple.

So as this discussion ensues today, the question is how do we be sure that we have a strong manufacturing sector, how do we support that? I assume that all of you would agree that, for example in the area of steel—and let us just use that because it has been mentioned today—became very, very efficient, highly productive, and that we are losing ground. I assume—would all of you agree that that was because of unfair trade and perhaps for a long while the lack of enforcement of trade agreements? Is there general agreement on that?

Mr. JASINOWSKI. Well, I think that I would add some points to that, Senator Dorgan, which is that, notwithstanding the efficiency of the American steel industry, many of which are my members, there was a tendency for some of it not to be so efficient. We have too much steel supply worldwide and there needs to be a restructuring. That is point No. 1.

Second, there is a host of other things that have caused problems in steel, from high energy prices to regulations and these extraordinarily high interest rates.

Having said that, I certainly agree there has been unfair competition and support of the 201 action that has been taken. So I think it is a mixed bag. The steel industry's problems are not simply the result of unfair trade.

Senator DORGAN. A fair point. Let me just make a couple comments. One, I think we negotiate trade agreements that are terribly unfair to our country's interests. There is too much foreign policy and too little hard-nosed economic policy in our trade agreements, No. 1.

No. 2, there is pathetically little enforcement of trade agreements. It is just pathetic. That is true of Mexico and Canada, it is true with China and Japan and Korea. We just do not enforce trade agreements at all, and shame on us. We owe it to our producers and our workers to enforce trade agreements and ask other countries to own up to the things they have signed up to.

Mr. GRISWOLD. Excuse me, Senator. You did ask if we all concurred.

Senator DORGAN. Yes.

Mr. GRISWOLD. I have to say I do not agree that steel's problems are principally unfair foreign competition. One, that is a very subjective term to nail down. U.S. businesses engage in the same sort of practices foreign producers do every day, selling at below cost, selling at different prices in different markets. It is just that we have one set of laws for foreign producers and one for domestic. That is one question.

Second, a lot of what I said about manufacturing generally applies to steel, and that is in the year 2000 the steel industry, shipments of the U.S. steel industry were 109 million tons. That was the most steel that was shipped in 25 years. We are producing more steel than we produced in a quarter of a century. It is just that demand up until the recent slump had outpaced our capacity to produce. That is why more imports were coming in.

The reason why steel employment has been declining relentlessly in the steel industry year after year is because of increasing efficiency. We have 60 percent fewer steel workers than we did 20 years ago, not because we are producing 60 percent less steel, but because it requires 60 percent fewer man-hours to produce a ton of steel. We are actually producing more steel than we were 20 years ago, doing it with 60 percent fewer workers, because those workers are so much more productive than they were 20 years ago.

If you want to cite a problem in the steel industry, that is it, rising productivity, driven largely by the minimills.

Mr. JASINOWSKI. Can I comment on that? What the steel industry did in the 1980's was extraordinary. They cut their labor force by half. They invested loads and loads of money in new equipment, becoming modernized. They went through a restructuring that is probably unsurpassed in manufacturing in the globe.

Yet, because of this overcapacity—now, it is not a question of blaming foreign competitors. It is about looking at the world as it is, a world with an overcapacity in steel and a market in this country that is open to everyone else. Because of those conditions and the high dollar, all of this effort to invest, to downsize, all the pain that the steel industry went through, was really for naught. Would an investor today looking over the American landscape, the landscape of the American economy, put money into an industry that had gone through all of that and still got hammered in world competition?

It became the most efficient steel industry in the world and still, because of what I would call neglect, benign or otherwise, on the part of the U.S. Government, we allowed this key industry to go through all that and did nothing to put a buffer between it and this global overcapacity out there. So that the lesson for an investor is, why invest in manufacturing if that is going to happen?

Mr. BAKER. Senator, if I can.

Senator DORGAN. Yes, Mr. Baker.

Mr. BAKER. Just to be very quick on your comment, I would have to disagree slightly in the sense I think the overvaluation of the dollar by 20 to 30 percent is probably far more important than any unfair trade practice that may exist.

Just to comment on my colleague's point, the fact that we are producing more steel than we did 20 years ago is not saying much. The economy is nearly twice as large, so we should expect that.

Senator DORGAN. The Chairman has been very generous. Interest rates I think are very important. I share Mr. Jasinowski's hope that the Fed will do the right thing and reduce interest rates by another 50 basis points. I think they are obviously confused about this economy, have been for some long, long while. It is a new economy. None of us quite know how it works, but that certainly applies to the Fed.

I am also very interested in this issue of currency fluctuations. I guarantee you the next trade agreement somebody is going to want to negotiate they will not worry about currency fluctuations. That will be an ignored topic. Yet all of you described this as something of significance.

Let me make one final point, Mr. Chairman. I have been looking again at the issue of automobiles with Korea because I am interested in Mr. Griswold's point about manufacturing. We imported roughly 450,000 cars from Korea last year, roughly 450,000 to 500,000 automobiles. Any of you know how many we shipped to Korea?

Mr. GRISWOLD. It is a very small amount.

Senator DORGAN. Twelve hundred.

Mr. GRISWOLD. I would say we have 450,000 happy families that have cars.

Senator DORGAN. Yes, but we are talking about the manufacturing sector today. So if we have 450,000 cars manufactured in Korea by happy Koreans who have jobs in the manufacturing sector and we are able to move—one would presume that you would agree, Mr. Griswold and others, that we have pretty good automobiles these days. We can only get 1200 U.S. cars into Korea in a year. Would that suggest that that injures our manufacturing sector, to have a circumstance in trade where you have that kind of imbalance? In my judgment it is clear, and yet you talk about the happy families being able to drive a Korean car.

What I look at is a circumstance that this country is not insisting to other countries that part of the admission price for being able to access our marketplace is to have your marketplace open to that which we produce.

Yes?

Mr. JASINOWSKI. I would agree with you about that. I think we must open up these markets where we do have tariffs or quotas that prevent us from selling in those markets.

But I wanted to go back to the overvalued dollar or the currency probably, because I do not think, Senator Dorgan, as you would conclude, I am sure, that we have to stand by and accept this.

Senator DORGAN. That is right.

Mr. JASINOWSKI. I think there are measures to take. One is to reduce interest rates further, which would help align the exchange rates.

The second is for this administration and Secretary O'Neill not to talk about the strong dollar as if it is an unmitigated wonderful thing and that we should just have it get higher and higher and higher. I think that the Treasury ought to be silent with respect to those issues and allow markets to determine it.

Third, I think we could have, and my colleague is proposing today, the Commerce Department do a special analysis of the impact of the fluctuating exchange rates and high dollar on manufacturing in the American economy. We need to know more, as you have suggested. We ought not to bail out Japan. I think those kind of policies will allow markets to adjust in a way in which we would get a more realistic dollar.

Senator DORGAN. Well, the words "strong dollar" provide positive connotation. In fact, it is overvalued or expensive. I mean, those would be better words to use in terms of the consequences of that kind of fluctuation of currency values. But I think it is a very serious problem.

Mr. FAUX. Could I just quickly point out that a high dollar also provides benefits to people who import. So what we have here, what we have to look at, is who is winning and who is losing, who is gaining and who is losing from these policies. The policy on the dollar ought to be included in this trade conversation.

Senator DORGAN. Mr. Chairman, thank you very much.

The CHAIRMAN. Thank you very much.

Senator Allen.

STATEMENT OF HON. GEORGE ALLEN, U.S. SENATOR FROM VIRGINIA

Senator ALLEN. Thank you, Mr. Chairman. I applaud you for having this hearing. I will only make a few comments.

I have been reading through all the remarks. I was over on the Banking Committee introducing someone earlier. The comments are all very cogent and all worthy of consideration. I am for free and fair trade and I do think that there should be markets open for our products, because I have faith that American workers and technology can compete with anyone in the world.

But we do—and I do agree with Senator Dorgan's comments—we need to enforce these agreements. No business would enter into contracts and just sluff it off if somebody is violating that agreement, that contract. I do think that we need to be very strong in making sure that, whatever the agreements are, that there is reciprocity. If we have Chinese goods coming into our country, we need to be able to get our goods and our products in to their customers.

Now, granted you say, "Oh well, China, only 10 or 15 percent of their population, maybe 20 percent, can afford it." Well, heck, that is a pretty good market. That is 200 million people. That is the same market as the U.S. So that is important.

When you look at trade deficits, one of the reasons we have a trade deficit is our energy policies. So Senator Dorgan is going over to an Energy meeting. A lot of it is oil imports. So we do need to have our own, more secure, energy policy in this country. Again, technology will matter.

But I have faith, Mr. Chairman, that the United States can compete and succeed with anyone in the world. We need to be a leader. We need to make sure that our tax policies are competitive and not overburdensome. We need to make sure that our regulations are based on sound science, not political science. We need to embrace advances of technology which allow our manufacturers to manufacture more efficiently, with better quality, with fewer imperfections, and also be good for the environment as well.

The key to all of this, though, will be knowledge. In our country, the only way we are going to compete and succeed is with knowledge. The people in this country need to be getting a good quality basic academic education in K through 12 so that when they go on to community college or the field of work or universities or colleges they have the appropriate knowledge.

While we are benefiting to some extent by immigrants coming in in technology fields, we need to make sure that every single American student who is trying, is getting a good education, because knowledge will be more important than ever. We cannot compete with those who pay a dollar an hour wages in other countries. It is a war of competition.

I will always remember going to Fieldale, Virginia, to a Fieldcrest mill. They were putting in new yarn-spinning equipment for their towels and so forth, and they were showing me those old bobbers and spinning wheels and so forth in there. I said: Well, what are you going to do with this old machinery here? Are you going to sell that off? They said: "No, we are just going to cut this stuff up and melt it down." If that got into the Philippines with the wages that they pay there, that equipment with the lower wages would be very efficient and that would be harming them.

So when you look at others like the Parkdale Mills or Magnolia Manufacturing, for example, in Hillsville, Virginia, Carroll County, they have the most up to date spinning equipment and technology and they are exporting actually to Mexico from Carroll County, Virginia. So we can compete, but we do need to have the most advanced equipment and technology.

Now, the bottom line when you do all these pluses and minuses, and you carry on about all these wonderful subjects and theories and principles and philosophy that I generally am in agreement with—it is basically a net plus in Virginia, international trade is a plus. Some of it is because of our ports. Even if the origin or the destination is not in Virginia, that is good because of our ports and airports and so forth, it is a net plus.

But I would hope that people would also recognize that there are some losses due to international trade. In the textile industry, I am sure in South Carolina, which is doing great as an economy in attracting international investment, as has Virginia, North Carolina, Georgia, and Tennessee and other States that have good economic, tax, regulatory and labor policies, right to work States and so forth—all that matters.

But there are good, decent, hard-working people who are losing jobs due to international trade or international competition. The Congress wisely, in the midst of the NAFTA agreement, put in a provision to help with transition benefits, for job training, for job search, re-education, retraining, and I think that is very important.

I also saw in Henry County in the Martinsville area where thousands of jobs, nearly 4,000 jobs, were lost right before Christmas about a year and a half ago. It was like a bomb hit that community—this was Toltechs that shut down. These people who were working at Toltechs, and others like Plume and other textile industries, were caught up in this international competition.

I am not saying NAFTA caused it, but that is the general view. "NAFTA" is a dirty word in that area. Those jobs may have been lost eventually anyway regardless of NAFTA, unless we are just going to close our borders preventing consumers in our country from buying products made elsewhere.

But the worst thing of it all was these folks who maybe even had generations of people, very loyal workers and families working for these companies, who were losing their homes. I would think that what we could do is look at ways in these transitions where good, decent, hard-working people with a good work ethic are losing their homes to provide maybe a transition loan to them, a bridge loan, so that in the midst of those transitions of trying to find a new job, being re-educated, retrained, that they do not lose the biggest asset in their entire life, which is their home and all that equity. Plus it has a terrible impact on the rest of the economy and the real estate market.

But those folks, we ought to have a bridge loan for them. Do not make them pay any principal or interest on it for say a year, and when they get back on their feet let them pay it over several years, so in the midst of this, these real live people in the real world, while we talk about trends, trend lines and principles, let us make sure that we are treating these folks like there was a natural disaster.

When a flood comes in or a hurricane hits, we help people and get them situated. Some of these situations where literally thousands of jobs are lost are like a natural disaster. It is an economic disaster. These people are not malingerers, they are not lazy, they want to work. They had been working, many long hours.

So I think that is a way that we can put some compassion, let us say, or reality in helping folks in the midst of these situations.

So I look forward to our debate on various trade issues and discussions about the Trade in the Americas. It may be an occasion for us to revisit transition assistance to folks who do lose jobs, certified that they were lost due to international competition, so that they do not lose their best asset, their biggest asset.

Mr. FAUX. Could I make a comment on that, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. FAUX. I think you are absolutely right about that. I think we do very, very little, Senator, for people who are in that situation. Job training is inadequate. Certainly people ought to be given an ability to adjust.

Having said that, when you look at the numbers of the trade deficit and you look at the relentless increase in that, the problem I think that we face is not just the normal transition in a market that fluctuates and a community with a firm that suddenly cannot compete because consumer tastes change, etcetera, but now we are faced with a situation that we can expect more and more and more of these because of this relentless increase in the trade deficit, which means we are importing more than we are selling.

So that we are in a problem that is not just a transition to another equilibrium, as an economist would say, but we are in something like a free fall. So while we have got to make those adjustment policies, we also have to look at our trade policies.

It is not a question of trade versus no trade. We have been a trading Nation since we started and we are going to continue to do that. The question is what are the strategies and policies that we ought to pursue that will allow us to be successful and to reverse this relentless increase in the trade deficit.

Mr. JASINOWSKI. Senator, may I comment on your comments as well? I wanted to just say that, representing 14,000 companies and one of the strongest proponents of open trade in this city, that I could not agree with you more about the need for us to recognize that in some cases trade does cause dislocations, it causes unemployment, and we simply must in the business community be more responsive to that.

I told my staff when I was preparing this, because I got into it at the last minute, I said: You are a little too unmitigated or unqualified about how trade is just wonderful in all cases. It is not wonderful in all cases. There are these dislocations and I think we must respond to them with compassion and intelligence.

I would differ from Jeff, however, and I would put a lot more emphasis, as you did, on the education and training. We face an education and training crisis in this country apart from trade, in addition to trade. It gets much worse and if we do not respond to that, we are not going to be successful.

Then the other things you mentioned—energy. It is all well and good to keep coming back to trade, saying it is causing these unemployment problems, but the unemployment problems over the last couple of years had almost nothing to do with trade. It has been excessive energy costs, it has been high interest rates and all the other things that you mentioned.

So I think we have to have a balanced policy, which I think is what you said and which we very much agree with.

Senator ALLEN. Thank you.

Mr. BAKER. I will be very quick. I think all of us support trade. I really do not think that is the issue. The question is how to structure it. Really, the course of the trade agreements passed over the last three or four decades has certainly been to put U.S. manufacturing workers, who are overwhelmingly non-college-educated workers, in competition with the lowest wage labor anywhere in the world.

That has the predictable result of depressing their wages. We have actually seen over the last 20 years there has been a big split between the wages of college-educated and non-college-educated workers. We did not see that before. Part of that, as I say, not all of it but part of it, is due to putting them in competition with people in developing nations who get very low wages.

Part of it also is we protect the higher end of our labor force. I know there was a piece in The Times a few years ago about how doctors were complaining that foreign doctors were coming into the Nation and pushing down their wages, and there were restrictions put on the admissions of foreign doctors into the United States.

I can say as an economist I feel largely protected from foreign competition. We have accountants, lawyers, doctors, other highly paid professions that we have not gone around trying to standardize our laws and our regulations so that smart kids from Mexico or India or wherever can just come here and practice those professions. We have very serious obstacles to that. We have gone around making it very easy for auto workers in Mexico and China and other places to compete with our auto workers, and that has had the result that all of us would have expected. It has driven down their wages.

Mr. GRISWOLD. If I could just respond to a few things. First, Senator Allen, I think you are exactly right that education and training is the key. You know, two and a half million Americans lose their jobs every year through layoffs and job churning. Only a quarter of those are in manufacturing. Montgomery Wards laid off 20,000 people recently. We need to talk about job retraining for them.

It is not a trade problem. It is not a manufacturing problem. It is just a fact of life in a dynamic economy that jobs are going to shift.

Second, a warning about talking about reciprocity. I think I got a chuckle from a few people when I mentioned families being happy buying new cars. I think families, consumers, are underrepresented in the halls of Congress. Let us not forget about them.

The people who pay the highest price for South Korea's difficulty in importing cars are the South Koreans themselves. They have a lower standard of living because of lingering protectionist trade policies. Let us not mimic their bad policies by imposing costs, basically a higher tax on U.S. families, just because they make policy mistakes.

Finally, this talk about the relentlessly growing trade deficit. Well, as a matter of fact we got some new numbers out this morning and, as in many recent months, the trade deficit is actually going down. Trade deficits tend to contract during bad times because, as I showed, imports tend to fall off as general domestic production falls off. So the trade deficit has not been growing relentlessly and when the trade deficit does grow the rest of the economy tends to do better because we are drawing in these imports, we can afford to buy more.

Actually, manufacturing output grows about four times faster during years when we have an expanding trade deficit than when we have a contracting trade deficit. If you really want to see manufacturing grow, you should welcome news about an expanding trade deficit because the two tend to go hand in hand.

Mr. FAUX. Mr. Chairman, if I can just briefly respond.

The CHAIRMAN. Please do.

Mr. FAUX. It is an interesting concept that as we grow we increase our trade deficit. That would suggest to me that there is something structurally wrong in the way we are operating our manufacturing. If in order to grow—and I think I do not dispute the numbers—we have to suck in more imports, that means that suppliers who used to be in the United States are someplace else. This is a result of a history, not just something that happened in the last couple of years, but a history of the erosion of the manufacturing base.

There is something structurally wrong when the more we grow the more our trade deficit grows. That cannot be a recipe for a healthy economy. As we explained before, sooner or later the day of reckoning on that debt will come.

Mr. JASINOWSKI. Mr. Chairman, I am going to have to excuse myself. I just wanted to thank you and ask you if you wanted to raise any questions before I left. I am sorry for that inconvenience.

The CHAIRMAN. Very good. What I really wanted out of each of the four witnesses are some solutions. I will have to object with the testimony relative to the fact that we really do not have any worries, everything is up to date in Kansas City, we are the most productive, do not worry about trade deficits, after all this is just a slight turndown, we are getting in a lot of new foreign industry, and on and on.

That is not the fact. Dr. Jasinowski, I want you as the head of manufacturing—you have got 14,000 companies—to tell me what to do.

As Governor Allen and Governor Hollings, we have been in competition. I started this thing over 40-some years ago with my friend Luther Hodges from North Carolina. I was the first Governor to go to Latin America to look, not McDonald jobs or laundry jobs or retail jobs. We know just from nickel and dime dealings—read Barbara Ehrenreich book—where we are headed.

I mean, yes, they are getting all these other little jobs and the overall job picture might look good as they continue to report. But the truth of the matter is they are losing manufacturing jobs, Dr. Jasinowski, your particular jobs.

I have resources that report these job losses: industrial output down in May; Greenspan to worry about idling factories; Business Week again, the industrial weakness; U.S. industrial output falls for the eighth consecutive month, and on; The Financial Times, the manufacturing slips further. Then some of you here on the panel are telling me, not to worry.

When I listen to my friend Mr. Griswold here, he reminds me of that tenth round boxer. He is in there just getting knocked all over the ring. He gets back to his corner. His second is slapping him: He has not put a glove on you, you are doing great, he has not put a glove on you. He said: "Well, for God's sake watch that referee, because somebody is knocking the hell out of me over there".

They are telling me I am in good shape. I have lost 32,000—let me get the figure here—32,900 manufacturing jobs since NAFTA. There has been a big swishing sound. We have all heard it all over South Carolina. Also, I've actually lost 43,200 textile jobs.

Yes, we got in BMW. I helped bring it in. But there is no question about it, we have a net loss. When little South Carolina is losing jobs since NAFTA, 32,900, and they tell me that a great swishing sound never happened, I want to take my friend to South Carolina and show him.

What do I do about it?

Mr. JASINOWSKI. Well, Mr. Chairman, if you would allow me to go back to what I said at the beginning, which is everything is not great. We are in a recession. The recession is as serious as the last one. Manufacturing output, all the numbers you identify, are in fact true. I said that there were a variety of causes of that. The first and most important—and we have to address each of those—interest rates.

The second is of course these energy costs. The education costs reduced the growth last year by over a percentage point. I mean, they skyrocketed out of sight. You have got in addition to that this extraordinary overvaluation of the dollar. That is probably causing more job loss in South Carolina than any other single factor.

Then you have got issues like rising health care costs. Health care costs went up 10 percent last year. When that happens, you simply have to cut head count.

Now, if you turn to the trade side—but you cannot take it separately. You have to do all these domestic things, as you know very well. If you turn to the trade side, it starts with the dollar and then I think we have to look at all these agreements in the way in which they are responsive to fair and open trade.

If we do not, however, move forward with some of these trade agreements, how do you reduce the tariffs in Korea so that we can in fact ship more cars there? If you look now at the tariffs in other countries around the world, they are much higher than they are in the United States. Trade is a weapon as well as a vulnerability. I think that we need to work together to be sure that the trade agreements are tough. Let us not be simpleminded and simply pretend that we can negotiate with the Chinese or anybody else and open our markets and not insist that their markets be opened.

But right now we are at a disadvantage with respect to many of these countries and we must negotiate additional agreements to reduce their tariffs.

Then finally, I think terribly important is this transitional aid that Senator Allen spoke about. So we need an overall economic growth and trade strategy for manufacturing, of which the trade strategy must be proactive and not protectionist.

Mr. BAKER. Mr. Chairman, if I could very quickly comment.

The CHAIRMAN. Very good. Dr. Jasinowski, if you have to excuse yourself, we understand.

Mr. JASINOWSKI. Thank you very much, Mr. Chairman.

The CHAIRMAN. We thank you very much for your appearance.

Mr. BAKER. I just want to comment very quickly about Mr. Jasinowski's point on energy. All of us would like cheap energy, but the fact is energy prices fell a great deal in 1997, 1998, and 1999, and I would trust very few of Mr. Jasinowski's members expected those prices to stay very low. So in other words, if they acted as though those very low prices were normal and are suddenly surprised, I think that is simply bad business more than a problem of our energy policy.

The CHAIRMAN. Well, I wish I had that article from last September's Business Week. In fact, they were talking about earlier in the year of last year where the market experts at the New York Stock Exchange had counseled the oil companies to cut back on production to get their stocks up because they were not competing with the high tech stocks, so to cut it back.

So now they cut it back and a year later they call it a crisis. There is no real crisis there.

You gentlemen all talk about not worrying about the high tech industry. Yet 42 percent of Silicon Valley is part-time employees. They have no health care and they have no retirement plans. I want more manufacturing jobs. That is middle America. That is the strength of the democracy.

At the BMW plant, Mr. Griswold, over 50 percent, over half have lived there all of their lives, within 50 miles of that plant there in Spartanburg, South Carolina. We had never before made a car in South Carolina in our lives. But BMW came to South Carolina and not Detroit because we have the training.

BMW can train you in any kind of real manufacturing production.

But it is going overseas, Senator. I was amused because I have been in this debate since I have been in the Congress and my Boeing friends out there in Seattle and everything say protectionist, protectionist. I am a protectionist. We have the Army to protect us from enemies outside our borders, the FBI to protect us from enemies within, Social Security to protect us from the ravages of old age, and Medicare to protect us from ill health.

Fundamentally government is to protect the economic strength of this land. It is like on a three-legged stool of security. You have got the one leg of our values, unquestioned. You have got the second leg, the military, unquestioned. But the economic leg is fractured and we have got to strengthen it, and we have got to do it through manufacturing, through middle America.

I just hate to get all of these economic rationales of how everything is confused with the important issues of job training or oil imports. I just do not want to clutter the record. I got word yesterday from the International Trade Commission that everything is in a deficit. I am meeting with them this afternoon, but I was amazed. Of course, they have got agriculture in there and I find out that we have got a deficit in the balance of trade with the People's Republic of China in cotton. Can you imagine that?

And they can exceed us—we will have it soon in wheat, and then the Midwest crowd will sober up. You know, they talk about us in textiles. They get subsidies, you know what I mean. Their entire operation is protected and everything else; they cannot lose.

But in any event, let me ask—oh, on steel. You do not put it off on steel. We started with McNamara running all around the world with the World Bank, and they tell every emerging Third World country that you have got to have the steel for the tools of agriculture and the weapons of war. Willy Krup from Germany, I dedicated one of his plants 40 years ago on the Rhine in Kiel, Germany, right across from Strasbourg. He built them all over America, all over Saudi Arabia, and when he went into an air crash he was building them in the People's Republic of China.

We have got Nucor, the most competitive steel plant that you could possibly find. He built Georgetown, but they just declared bankruptcy. Why?, because they are dropping the price of steel. Whoever testified was exactly right. When they dropped the steel $24 more than we charge rather than the 176, they are dumping it at less than cost.

So we have these hearings on dumping and you go before the International Trade Administration and they find a dumping violation. But you go over to the fix commission, the International Trade Commission, and, oh, there is no injury, and they give you this economic rationale and we continue to go out of business.

When you lose 675,000 manufacturing jobs in 10 months, we in Congress have got to take note. We have got to take note.

Now let me yield and let each of the three comment. Yes, sir.

Mr. FAUX. Starting with steel, it seems to me, Mr. Chairman that it is a great example of why our trade policies are failing. For a long time our trade policies were a function of the cold war. We parceled out the U.S. market to provide people with an incentive for being on our side. Well, the Soviet Union has been out of business now for more than a decade, but we are still operating trade policies on the basis of objectives that are not connected to the considerations for developing high-wage jobs in this country.

Steel is a perfect example. If you are looking out at a world which has this huge overcapacity, in part because the World Bank and the IMF and others have done it, but if you are looking out at that world it makes no sense to have a trade policy that assumes somehow that we can get our share competing against people who are subsidized and whose wages are below the productivity gap.

Let me give you an example of that. I was in northern Mexico a little while ago and I went into a plant where they make television sets and parts for TV's. It was a Sanyo plant. I asked the manager what was the productivity of this plant in terms of skilled workers producing high-quality goods? He said:

> "Well, we have been in business for 4 years. It took us 2 years to catch up to the Koreans and now we have the productivity that equals plants in the United States and in Japan."

So I said: "Well, OK, your productivity is equal; what is the ratio between the entry wage here and the entry wage at a similar plant in the United States? Without blinking he said: "It is one to ten."

Now, if your labor productivity is the same and you are paying 10 percent of the wage cost, you have a comparative advantage that no genius entrepreneur in the United States is ever going to be able to overcome.

So what should we do about it? First I think we should have a pause in the breakneck speed that we are on to sign trade agreements all over the world. We do not need to do the Free Trade Agreement of the Americas, which would expand NAFTA to the rest of the western hemisphere, before we have absorbed the lessons of NAFTA.

We were told before NAFTA that we would have a trade surplus with Mexico. It turns out we have a trade deficit. I remember journalists and people in this building asking me: "What are your friends in the automobile industry worried about?" "What are those auto workers worried about?" They will get great jobs because we will have a trade surplus on autos with Mexico, all those Mexican consumers buying U.S. cars.

None of that worked out. Now, the point is not that people made mistakes in forecasting the future. The point is we made this treaty on the basis of assumptions that have not turned out. It is now time for us to look at that again and say, where did we go wrong and what do we have to do when we do the next treaty in order to make sure we do not repeat those mistakes.

No business would be losing money for 20 years without asking itself, are we doing the right thing here? Well, essentially we have been losing money for 20 years on trade and it is about time to ask ourselves what are we doing.

I think that the dollar issue is a major question. I think there is a mystery here that we have got to clear up. We have reduced interest rates relentlessly over the last 6 months and we still have a dollar that is overvalued. The Fed does not know what to do with it. We have got a world out there that we do not understand and it is suicidal for us to keep signing these trade agreements, essentially doing the same thing we have done for the last 10 or 20 years.

We certainly need a commitment to lowering the value of the dollar. I also think that we need a strategy for manufacturing. Every other country in the world has an industrial policy. Our industrial policy is entirely a function of defense spending. That is our manufacturing policy.

The CHAIRMAN. What was that?

Mr. FAUX. Our manufacturing policy in this country is entirely a function of defense spending. That is the only area in which we pay any attention to the issue of a healthy manufacturing. Now, it obviously makes sense for national security to do that, but we have lots of other considerations that we talked about here in our national interest in having a strong and healthy manufacturing sector.

I also think that we need to reorganize the way that we do trade policy. As I said before, trade policy has become focused and obsessed on deal-making. If I were appointed to be USTR tomorrow and I was looking at what would be my success in this job, the success would be make a deal. No matter what, make a deal. It is not guided by any policy. Deal-making has become an end unto itself in trade relationships, rather than a function of our national need to have a healthy economy.

Some deals may be good, some deals may be bad, but they should be based upon a notion of what is good for the country, not on what is the best deal you can get. So I think that we need to take a serious look at the way we do trade policy. Any trade agreement that does not look at the issue of currency fluctuations and currency exchange at this point in the game is certainly not worth signing.

The CHAIRMAN. Thank you.

Mr. Baker.

Mr. BAKER. First off just in terms of the backdrop, one of the things that to me I think should be front and center is we are looking at a period, a quarter century, where the economy has had pretty healthy growth through most of that. Productivity has increased roughly 45 percent over the last decade—or the last 25 years. But if we look at the wages of a typical worker, it has barely changed, depending are we counting benefits or which price indices. You know, and we can play around with that a little bit.

But the point is if they had kept pace, if your typical worker had kept pace with the rate of productivity growth, they would be 30 to 40 percent richer than they are today. To me that is a crisis. What is this country about, what is our policy about, if not to ensure that most of the country can enjoy rising living standards through time? That to me is sort of the greatest tragedy that we could talk about, that we could say for a quarter century there is very little to show.

Now, I do not mean to say trade is the whole story, but clearly it is an important part of that. I do not know any economist—perhaps I will get an exception here with my colleague, but I cannot think of any economist who has argued that it is not part of that story.

So I think we have to keep that in mind as the backdrop. The second point, not to keep beating a dead horse on this, but the strong dollar. You know, we send our manufacturers out there into the world with a 20, 25, 30 percent handicap competing with other nations. How could you possibly hope to compete, regardless of whether they are being fair or unfair or whatever it might be? Going off the bat, they have to compete with nations that in effect have a 20 to 30 percent cost advantage simply because the dollar is strong.

I have heard a lot of people say, well, what would you do? I am a big fan of talk. I think that sometimes talk goes a long way, and certainly Chairman Greenspan's talk goes a very, very long way because he is so strongly respected by financial markets. I was sort of struck. He was testifying yesterday, I believe it was before the Senate Banking Committee, and he tried talk there. He suggested that bank loan officers were being too tight with credit and he urged them to loosen their standards.

I would just question to you, which sounds more plausible, that bank credit officers will change their lending standards, in other words give a loan to someone they otherwise would have rejected because Chairman Greenspan said it would be good for the economy, or that if Chairman Greenspan says, "Look, the dollar is at an unsustainable level, it has got to fall?" I suspect the latter would have more of an impact, and I would have liked to have seen that sort of talk from Chairman Greenspan and perhaps also from the administration.

The last point I want to make is just to reiterate Jeff's point about the need for a pause in these agreements. You know, we should say, OK, fine, maybe we want to do an FTAA with the rest of Latin America, maybe we want to go along with other trade agreements. But the question is what is the cost of delay? Suppose we waited a year, suppose we waited 2 years, suppose we waited 3 years.

We have heard a lot of talk, well, others will get in there sooner. You know, let us have someone do a cost-benefit analysis of that. What would that mean? Who is going to get there sooner? They will not trade with us 3 years from now?

It is a little hard to tell that story, I think, with a straight face.

So I think the point Jeff made is very well taken, that let us get a better analysis of the impact of the past trade agreements, let us get the currency sorted out, because as long as we have a hugely overvalued dollar trade is not going to make sense in any respect, and then down the road, some time down the road, if we want to have more trade agreements, fine. But we are not going to lose anything by waiting 2, 3, 4 years, whatever it might be, to get things straightened out. So I would put a very strong emphasis on putting the brakes on for now.

The CHAIRMAN. Mr. Griswold.

Mr. GRISWOLD. Senator, you started asking about steel. Let me just reiterate that the steel industry is not going away and it is in no sign of going away. Record production last year, the highest production in 25 years last year, 109 million tons shipped. Nucor, one of the most competitive companies, Nucor is going to be around no matter what happens on the trade front.

I think the problems of the steel industry are worth a whole other hearing and I am sure there will be more. But they have a problem. They are not globally integrated. It is a fractured industry. They have just got a lot of problems, but the bottom line is they are virtually all home-grown.

Third, let us not forget steel-consuming industries. They use a lot of steel at that BMW plant and in Detroit. These fabricated metal shops all around the country—the construction industry uses I believe about a third to 40 percent of the steel produced in the United States. When you drive up steel costs through, say, a section 201 action, you raise costs for all these industries, and for every worker in the steel industry there are 40 workers in these industries that use steel. You are making their jobs less secure by driving up the cost of steel through trade intervention.

Second, wages and benefits. Yes, we had some problems in the seventies and eighties with productivity. Productivity lagged, productivity growth lagged from what it was in the sixties and as a consequence the growth in wages lagged. But if you read the Economic Report of the President, especially the last two, they point out very clearly that in the last half of the 1990's we had this spurt in productivity.

Wages went up up and down the income scale. In fact, there was a lot of evidence that lower skilled, lower income workers were actually seeing their wages growing faster than upper income worker, at a time when, one, trade was expanding rapidly, trade deficits were going up. I am not saying wages went up because trade deficits went up. I am just saying that should give you pause in trying to blame everything on trade deficits.

Finally, you ask what we should do. I think, one, we should keep our market open. There are two very indisputable facts. One, we have one of the most open markets in the world; and two, we have one of the most productive, efficient economies in the world. Americans enjoy a standard of living that is virtually unparalleled in the rest of the world. That is why so many people want to come here.

We also have one of the most open economies. That should give us something to think about. Do we really want to follow Japan's example of a sort of heavy-handed industrial policy? You know, I had not heard the term "industrial policy" for a few years. Back in the early nineties we heard a lot of it. Here is the United States' industrial production: 50 percent above what it was 10 years ago. Japan, it is below what it was 10 years ago. Do we want to mimic Japan's policies? I say no.

Let us keep our market open. Let us pursue market-opening agreements abroad. If we are pursuing trade agreements at a breakneck speed, I would hate to see what it is when we slow down, because we have not signed many agreements lately. There have been small ones, but basically trade policy, trade negotiations, have slowed down very much.

But we need to sign agreements to encourage open markets abroad and to keep trade barriers down. Then finally, of course, we need to pursue sound domestic policies of low taxation, sensible regulation, stable monetary policy. These are the things that attract capital from abroad.

Yes, I do not doubt that there are some industries, like the textile industry and others, where the flow of jobs and investment has been to overseas. In a way, that is the natural evolution of economies. The less developed economies tend to take on these more labor-intensive, low-skilled manufacturing jobs. That is the only way they are going to join the developed world.

But as a whole, $36 billion a year in recent years has been coming into the United States. That is a net inflow of foreign direct manufacturing investment. 500 companies in South Carolina alone, as you know, from overseas, foreign-owned companies.

I would say let us pursue more open trade. It has been a blessing to the United States. It will continue to be in the future.

Thank you.

The CHAIRMAN. Very good. You talked about the standard of living. There is no question that we here in the Congress are responsible for the disparity or otherwise high standard of living, Baker Manufacturing, we all agree, whether Republican or Democrat, has got to have a minimum wage, clean air, clean water, Social Security, Medicare, Medicaid, plant closing notice, parental leave, a safe working place, and safe machinery.

I can keep going down the list, but if you can go down to Mexico at 58 cents an hour you do not have to worry. That is why the swishing sound is loud and clear.

Yes, we sacrificed that economic backbone in order for capitalism to defeat communism, and we all believed in the Marshall Plan and in the policy and we are very happy it worked. But we have gotten to the position now where we just cannot continue to drain the tub. As of NAFTA, and we have the figures from the Bureau of Vital Statistics in the Department of Labor, since NAFTA and WTO we lost 276,000 manufacturing jobs since NAFTA and since WTO 670,000 manufacturing jobs, respectively.

Now, we blame the Fed, but I think the record should show that the trade deficit was not helped a bit by our fiscal policy. We all talk about the short-term rates, but the long-term rates—I have got an article in here from two of the Nobel Prize winners, Mr. Franco Modigliani and Robert Solow of MIT—they are both professors emeriti of Massachusetts Institute of Technology, and we will include that in the record—where we went in the exact wrong direction with the so-called tax cut because of the large surpluses.

[The material referred to follows:]

[From The New York Times, April 9, 2001]

AMERICA IS BORROWING TROUBLE

(By Franco Modigliani and Robert M. Solow)[1]

CAMBRIDGE, MA.—Many have criticized President Bush's proposal for a deep and lasting cut in income taxes, but hardly anyone has addressed its implications for what may well be the greatest potential danger facing the economy in the years to come: the large and growing deficit in our international trade balance. A massive, permanent tax cut would make the international economic position of the United States worse, not better. This is in addition to its other disadvantages.

The past decade has been one of exceptional economic vigor: output increased nearly 40 percent, investment more than doubled and consumption grew just over 40 percent, pushed by a spending spree that reduced personal saving to near zero. But this rosy picture was accompanied by one worrisome development: throughout this period, spending grew faster than what the country earned, spilling over, in large part, into a growing trade deficit. By the end of 2000, the excess of expenditure over income had reached about 4 percent of America's gross domestic product and was apparently still on the rise.

For a country, just as for a family, there are only two ways of getting the money to spend more than one's income: borrowing it and selling assets. In the case of nations, the creditors and the buyers of the assets are foreigners. And inded, throughout this prosperous past decade the United States sold more and more assets, like government bonds and shares in its companies, and went deeper and deeper into debt.

But why should one worry about this development? It is not serious as long as the debt is small and remains under control so as not to worry creditors. But if the debt is not under control, or if some event makes the debtor appear less creditworthy than before, the creditors may decide that they are not willing to finance a country's growing debt—for fear of a depreciation of the debtor's currency that lowers asset values in their own currencies. They may even want to liquidate part of their investment in search of diversification. If such a thing happened to the United States, there could be very unpleasant consequences for Americans.

[1] Franco Modigliani and Robert M. Solow are Nobel Prize winners in economics and professors emeriti at the Massachusetts Institute of Technology.

Depreciation of the dollar would make imports so expensive and exports so cheap as to eliminate the trade deficit. But this depreciation would create a further motive for foreigners to liquidate their American assets, dumping the dollars so obtained in exchange for foreign currency. The size and power of the American economy has protected us from capital flight in shorter episodes of unfavorable trade balance, but there is no guarantee that this will remain true. Nor could the dollar be propped up through purchases by the Federal Reserve or the Treasury, since their small reserves of foreign currency would be woefully inadequate to stem the tide. (The United States reserves amount to some $60 billion compared with a current trade deficit of $400 billion a year, just 2 months' borrowing.)

Thus a flight from the dollar would produce a deep devaluation and accompanying rise in the prices of imports and of things made with imports. At worst we might experience a wage and price spiral, calling for sharply higher interest rates. The final result could be failing investment and output, and high unemployment. And our weakness would be very likely to spread to other countries.

Few believe that this hard-landing scenario is an immediate threat. But there is good reason to believe that if nothing is done to change the current course, the probability of a costly ending will keep increasing. To avoid that danger, the administration and Congress should develop a.plan that promptly stops the growth of the trade deficit, then reduces it to zero and possibly produces a positive balance, allowing for some repayment—and all this without an appreciable increase in unemployment.

The success of such a plan would rest on two main ingredients: a gradual reduction of total domestic expenditure relative to income—that is, a rise in national saving—and an increase in net exports. These two components should proceed hand in hand; indeed, given the current level of demand for domestically produced goods and services, if we added to it by shifting more of our output to exports prematurely, the result would be inflationary pressures. Conversely, a reduction of domestic demand would have to be ountered by an expansion of net exports to avoid creating a contraction in output and employment.

Unfortunately, there is no evidence that the administration and Congress are concerned with the balance of trade issue or are even aware of it. On the contrary, President Bush is galloping in exactly the wrong direction with his advocacy of using the likely (though by no means certain) large forthcoming budget surplus for a deep, permanent tax cut, rather than for retiring the debt or endowing Social Security—or both.

The president's proposal is just the opposite of the needed increase in national saving, and the consequences would be very negative. First, it would raise consumption by roughly one dollar for every dollar of tax reduction—which is precisely what the supporters of the bill claim to be its justification. But, given the limitations on our labor force and our abiity to produce, the rise in consumption would sooner or later produce some combination of the following unhealthy outcomes: significant inflationary pressures, in part undoing the tax rebate; a likely rise in interest rates to counter the inflation, leading to a reduction in investment; and a further increase in the trade deficit.

Can anyone really favor encouraging a further expansion of the recent spending spree at the expense of investment, the source of future growth? Or reducing taxes at the expense of a sharp addition to future taxes, required to service a much larger debt at higher interest rates? Or supporting a tax cut financed with money borrowed abroad, even in the favorable case in which foreign lenders would be prepared to finance a rapidly growing debt?

If Congress is acting responsibly, the least it can do is to postpone a deep permanent tax cut until this trade balance has turned positive.

But, some tax-cut proponents will argue, what if right now there is a clear danger of a significant economic contraction? If this were clearly the case—and it is still in doubt—then some measure to support demand might be appropriate. But the best approach would be to expand net exports, helping both domestic demand and the trade balance—perhaps by aiming at a controlled, limited devaluation of the dollar and by encouraging other countries, like Europe, to pursue more expansionary policies in their own interest.

It may even be justifiable to consider a modest, temporary tax cut, but with a warning that theory and evidence suggest that transitory tax cuts are likely to produce only limited, quick effects.

The CHAIRMAN. Any of you at the panel believe we are going to have a surplus at the end of this fiscal year in a few months, at the end of September? Do you believe we are going to have one, Mr. Griswold?

Mr. GRISWOLD. You are talking about the fiscal?

The CHAIRMAN. Yes, the budget deficit or surplus. Do you think we will have a surplus? We have had lowering deficits each year now for 8 years, but it has been my contention that we are headed back up with that tax cut. You think I am wrong, is that right? Do you think that we are going to end up with a surplus here?

Mr. GRISWOLD. Are you talking unified budget including Social Security?

The CHAIRMAN. Do not give me that doubletalk. Do not play that game. I can give you the exact figure. The so-called what they call public debt unified, not including Social Security and everything, is $114 billion that it has been lowered. But they borrowed $100 billion from the government in order to do that. We are spending Social Security money at this minute, and everybody is talking about how to save it. All they have got to do to save it is quit spending it, quit spending it. There is no mystery to this.

Do you think we are going to have the debt go up or go down as of the end of this fiscal year in September?

Mr. GRISWOLD. The trend in the last couple of years at least has been for the publicly held national debt to be going down.

The CHAIRMAN. No, no, do not give me—the overall national debt is what I am talking about, how much money comes in and how much money goes out, not what we borrow from each other.

Mr. GRISWOLD. Well, you would need to get somebody in here who is a budget expert.

The CHAIRMAN. Well, sir, I have been on the Budget Committee since we started. I am not an expert, but I have followed it.

Do you think we are going to have a surplus or a deficit? Is the debt going up or down by the end of September?

Mr. BAKER. We are going to have a certainly smaller surplus this year than last, and it may well be a deficit. But the one thing I would be willing to wager on is by your measure we would certainly have a deficit next year, because the prediction rests on us having somewhere on the order of $120 billion in capital gains tax revenues next year. With the stock market down as much as it is, I am willing to bet we are not going to see that. So for next year at least, I would feel pretty comfortable in saying by this measure of the on-line budget that it will be in deficit next year.

The CHAIRMAN. How about you, Mr. Faux?

Mr. FAUX. I think you do not have to be a budget expert, Mr. Chairman. You just have to look at the trend in the economy. Essentially, we have made a decision with this tax cut to borrow money in order to provide tax relief, mostly to people on the top. So that we may squeak by the end of October, but we are in bad trouble in terms of next year.

The CHAIRMAN. Well, as of last night we had $31 billion and we were in the black. But by next week, the end of June here, we are going to pay the interest cost, which comes every 6 months, and it will be around $79 billion. So we will end up this month with the debt increasing. There is no question that by the end of the fiscal year here in a couple of months, before we have spent any money with respect to any of the appropriations bills because we have not passed a single one of them, just on the present ones that we had the so-called tax cut, I will bet anybody—and if you want to take the bet we will talk about odds—that the debt will be increased at least $50 billion. How about that?

You see, you talk about the headline in the morning paper, the front of the Washington Post says, Mr. Greenspan is puzzled why his interest cuts have not worked at all. It is fiscal policy, it is not monetary policy. When the market and everybody else sees it, the economic slowdown, the demise of manufacturing and everything else like that, they see what happened when we cut $750 billion of revenues under President Reagan and we went into a deep recession. Now we are cutting $1.6 trillion from a so-called surplus that did not exist. We do not have a surplus. The debt is going up each year. We were bringing it down and finally into the black as of last night, $31 billion.

But by next week when they make that $79 billion interest payment, it will go back into the red, and it will stay in the red July, August, and September, and it will go right on up some 50 billion bucks at least.

But your testimony, you did agree I think on the overvalued dollar, and you gentlemen did agree that we need some kind of policy with respect to trade. There is no question about it. We have got 28 departments and agencies in it, and I have talked to Secretary Evans about it and we hope to develop, if we do not actually have a reorganization—I have put in a bill for 20 years on a Department of Trade and Commerce and correlate them all into one entity, and let us get competitive and everybody know and understand the policy. I hope we can do that. Along that line, your testimony has been very, very valuable.

We appreciate your appearance here this morning and the record will stay open for questions from the other Senators. Thank you all very much.

The Committee will be in recess until the call of the chair.

[Whereupon, at 11:33 a.m. the Committee was adjourned.]

APPENDIX

PREPARED STATEMENT OF HON. JOHN MCCAIN, U.S. SENATOR FROM ARIZONA

Thank you, Mr. Chairman—and thank you for continuing the dialogue on this important topic. While I know that members of this Committee do not always see eye-to-eye on trade issues, I think that we all benefit from this debate. Chairman Hollings, I would like to congratulate you for ensuring that both sides are well represented here today. I think we can expect a lively debate.

I am an active proponent of free trade, and it is clear to me that free trade promotes prosperity, both domestically and abroad. Trade produces wealth and technological advancement, thereby encouraging innovation, competition, and improved productivity. U.S. corporations are not the only beneficiaries of that free trade. Consumers benefit from the dramatically reduced prices of goods and services that trade brings, allowing them to stretch their dollars further. By 2005, the Office of the United States Trade Representative estimates that reduced tariffs will allow the average American family of four to almost double their purchasing power on household items.

This is by no means a new debate, but I hope that the protectionist tendencies on both sides of the isle will not deter the United States from enjoying the existing, and potential, benefits of free trade. Globally, the interdependence fostered by free trade benefits all global citizens. Multilateral trade agreements and membership in organizations such as the WTO advance democratic values and encourage free markets, transparency, and the rule of law. Conflicts and wars are less likely to occur between trading partners, freely exchanging goods and services. From this perspective, free trade is more important now than it has ever been.

While there are many benefits associated with free trade, employment displacement remains a concern in the trade debate. Job displacement is an unfortunate aspect of free market economies, whether due to technological advancement, changes in consumer preferences, or trade. Just as the automobile replaced the buggy, new technologies will continue to emerge, and old technologies eventually become obsolete. These changes naturally result in both the creation and the loss of jobs. While buggy manufacturers were forced to cut jobs, the new automobile industry created many more. This cycle will continue as long as innovation and ingenuity remain.

Today, much of our manufacturing labor force has shifted from labor intensive to capital intensive work. Not only are more Americans now employed thanks to freer trade, they now work in better, higher paying jobs. Export supported jobs pay an average of 16% to 20% more than the average wage. Trade has given workers the opportunity to earn more and stretch their dollars further than ever before, improving the overall quality of life. Workers displaced by major industrial shifts merit attention and concern, but do not in any way justify protectionist actions.

In general, U.S. workers benefit more from free trade than from protectionism. According to the Office of the U.S. Trade Representative, in just four years—from 1994 to 1998—1.8 million new jobs were created by the increased exportation of goods and services. During this same period, the unemployment rate declined from 6.1% to 4.5%. When the U.S. trade deficit expanded, unemployment levels continued to decline.

Isolationist and protectionist sentiments are natural in a nation as vast as the United States. For many years we did not need to rely on other nations to provide us with goods and services, we produced them ourselves. Today, our economic strength has created a demand greater than our production capacity, and we need to import goods in order to meet the demands of our consumers. Our trade deficit should be celebrated as a sign of our economic strength.

The world is now politically and economically interdependent. It is time to stop hesitating. Rather than fear freer trade, we must embrace it.

PREPARED STATEMENT OF HON. JEAN CARNAHAN, U.S. SENATOR FROM MISSOURI

We are all familiar with the manufacturing job loss numbers reported lately. It seems like you can hardly open the newspaper without reading about another factory closing and more job layoffs.

In the Midwest, new unemployment claims have risen almost 45% from the same time three years ago. There is little doubt that job losses are on the rise in the Midwest.

For example, Kansas City recently lost 750 good, high-quality jobs when GST Steel shutdown a steel plant first opened in 1888. Soon, a bakery that has been a part of St. Louis for sixty years will close its doors. 110 workers will be out of a job.

These are only a couple of examples of Missouri plants that have closed in recent years. There are many more examples throughout the Midwest and throughout the country.

When we see articles on these plant closings we see figures like 750 jobs but do we really recognize the impact of this fact? Do we see the impact that a plant closing has on the workers who lose their jobs, their families, and on their communities?

What happens to these laid-off workers? What happens to their families? What happens to the communities where the plants are located?

Often these workers are losing good-paying, skilled jobs. Are they able to find jobs with comparable pay or benefits or are they forced to take a lower paying job just to put food on the table? Are there adequate resources available to help a laid-off worker find a new job?

Is the spouse of a laid-off worker forced to leave the home or take a second job to pay the bills?

We cannot ignore the effect that a mass job loss has on the community in which a factory is located. Without a dependable source of revenue that came from the paychecks of these workers, local businesses, churches, and charitable organizations are bound to suffer.

There are many possible reasons to explain why these jobs are being lost and that is a whole other debate entirely. The key issue is ensuring that we are able to handle the aftermath of these job losses.

Bringing attention to what is happening in our communities through this hearing is a good first step in the right direction.

PREPARED STATEMENT OF THE AMERICAN TEXTILE MANUFACTURERS INSTITUTE

This statement is submitted by the American Textile Manufacturers Institute (ATMI), the national trade association of the United States textile industry. The combined U.S. fiber/textile sector, which includes cotton and wool growers, manmade fiber producers, yarn spinners, knitters, weavers and home furnishings manufacturers is one of the largest manufacturing sectors in the United States, employing over 600,000 workers and representing over $100 billion in sales.

The topic of this hearing—current conditions of U.S. manufacturing and the impact of the manufacturing recession—is a particularly timely and important one to the U.S. textile industry. Rarely, if ever, has a major manufacturing sector such as textiles, one which has successfully weathered the Great Depression and 12 subsequent recessions, seen its fortunes contract as swiftly and as devastatingly as they have over the past three and a half years.

To put the current crisis in perspective, in 1997, the U.S. textile industry posted record shipments, near-record profits, near-record investment in new plant and equipment, record fiber consumption, record productivity growth and record exports.

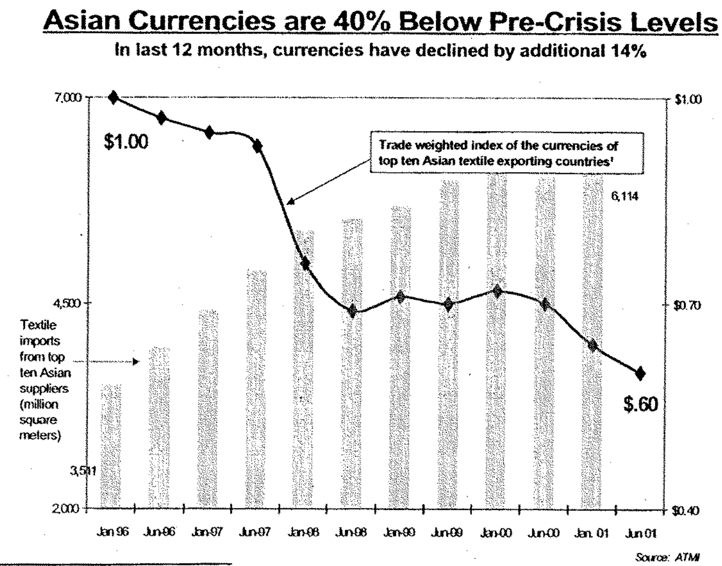
Last year, the industry posted its first ever annual loss (over $350 million) and has experienced 3 years of declining shipments and fiber consumption and 3 years of sharply declining prices. This year the crisis in the industry deepened further—in the first 6 months of the year, at least 44 U.S. textile mills have closed their doors, including two textile companies that had been in business for over 100 years. In May 2001 alone, 9,000 U.S. textile workers lost their jobs. Over the past 12 months, 10 percent of the textile workforce—56,000 workers—lost their jobs.

DEVASTATING EFFECTS OF ONGOING ASIAN CURRENCY DEVALUATIONS

The catalyst for the current crisis is the severe Asian currency devaluations that began in June 1997 and have continued to this day. As the accompanying chart shows, since 1997 the currencies for the top ten Asian textile-exporting countries have declined on average by 40 percent. The currencies of India, Indonesia, Pakistan, the Philippines, Sri Lanka and Taiwan are now at record lows. Imports of textiles from these and other Asian countries, after years of relatively low growth, have jumped 80 percent over the past 4 years.

In the face of these depressed import prices, U.S. producer prices for yarn and fabric have fallen sharply over the past 3 years. In late 1998 and 1999, U.S. textile profits began to plummet; in 2000, they turned sharply negative. This year, bankruptcies and mill closures escalated sharply as cash-flows all but disappeared. ATMI President Charles Hayes describes current industry conditions "as the worst I've seen them in 50 years in the industry."

This devastation has not only been wrought by artificially low Asian currencies. Unfortunately, U.S. Government policy as well as flawed international agreements have added to and deepened the current textile crisis.



[1] Trade-weighted index is made of the top ten Asian textile exporters to the United States: Pakistan, Thailand, India, South Korea, Taiwan, Indonesia, Philippines, Japan, Sri Lanka and Hong Kong (listed by volume). Note that China is excluded because China uses export tax rebates to devalue its currency and sector specific figures for those rebates are not available. However, China reported last year that its use of rebates was at record levels and had increased by 94% over the previous year. Source: currency information - Oanda, Inc.; trade information - U.S. Dept. of Commerce.

The rest of this statement examines the role that U.S. Government policies have, unwittingly or not, played in contributing to the current crisis. It concludes with a number of urgently needed action steps by the government to rebalance the competitive situation.

U.S. GOVERNMENT INACTION & FLAWED POLICY-MAKING

While the textile crisis was precipated by the collapse of Asian currencies, U.S. government inaction and flawed policies have made the crisis much worse. In particular, ineffective or harmful U.S. Government trade policies at the Commerce Department, the United States Trade Representatives Office, the Treasury Department and the U.S. Customs Service have cost the U.S. textile industry billions of dollars of lost sales a year and thousands of jobs. With the onset of the weak economic conditions in the United States, these policies have become a strong contributing factor in the devastation that is occurring today in the U.S. textile sector.

Ineffective or Harmful U.S. Policies

1. U.S. Customs: Refuses to Make Textile Fraud a Priority Despite Documentation of Dramatically Increased Smuggling From Asia
2. U.S. Treasury: Strong Dollar Policy Contributes to Artificially Low Asian Textile Prices
3. USTR: Continues to Ignore Industry Requests to Make Textile Market Access a Priority
4. Commerce Department: Regulations Hamstring Industry Efforts to Attack Illegal Dumping and Subsidization

1. U.S. CUSTOMS: REFUSES TO MAKE TEXTILE FRAUD A PRIORITY DESPITE DOCUMENTATION OF INCREASED SMUGGLING

Widespread Customs fraud totals billions of dollars annually and represents lost sales and jobs for U.S. textile industry. While U.S. Customs as well as the U.S. domestic industry have repeatedly documented a continuing flood of illegal textile transshipments through dozens of countries, U.S. Customs has proven unwilling or unable to devote the time and effort to significantly affect the flood of Asian transshipped and smuggled goods.

In the last 2 years, the domestic industry has raised new concerns about increased smuggling of Asian goods that pass through Mexico or are smuggled directly into the United States as "in transit" goods. In 2000, Mexican sources estimated that hundreds of millions of dollars of goods marked "made in Mexico" but actually shipped from China and other Asian countries are sold into the domestic Mexican market. Many of these goods then enter the United States as NAFTA products and pay no duty.

Independent investigations by ATMI which have been shared with both Mexican and U.S. Customs have also shown increasingly large amounts of smuggling of Asian textile and apparel products on the *U.S. side of the border*, usually going through San Diego, Nogales or Laredo and often marked as "in bond" or "in transit[1]" goods.

To its credit, the Mexican government has cracked down hard on its side of the border, seizing thousands of containers of illegal Asian textile products and replacing dozens of ineffective or corrupt customs officials. The U.S. Customs Service, despite its own internal reports that estimate up to half a billion dollars in Asian goods are being smuggled as "in transit" goods, has yet to act in an effective manner.

2. U.S. TREASURY: STRONG DOLLAR POLICY KEEPS ASIAN PRICES ARTIFICIALLY LOW

Since the Asian financial crisis began in 1997, the U.S. Government has promoted a "strong dollar' policy partly in order to assist Asian economies in exporting their way out of the crisis caused by widespread government mismanagement of financial sectors across Asia and partly to avoid U.S. inflationary pressures. The U.S. Government effort has "worked." Asian textile exports have risen 80 percent and Asian economies are again showing positive growth rates.

On the domestic side, however, the strong dollar policy has helped to unleash a flood of artificially low-priced Asian exports that has created a enormous swath of destruction in what had been a profitable, growing industry, one consistently ranked as among the most modern and productive in the world. Entire domestic textile complexes, full of State of the art equipment, are now being dismantled and sold, often to Asian manufacturers, at fire-sale prices. The strong dollar has also paralyzed U.S. textile exports—formerly a strong growth area—which make up nearly 15 percent of textile output.

By continuing to promote the strong dollar, particularly during weak economic times at home, the U.S. Government encourages this predatory behavior to continue full force.

The damage has not been limited to just the textile sector. The National Association of Manufacturers (NAM), in a letter to Secretary O'Neill, has called the effects of the strong dollar "staggering." NAM noted that "a growing number of American factory workers are being laid off principally because the dollar is pricing our products out of markets—both at home and abroad.[2]"

3. USTR: CONTINUES TO IGNORE REPEATED TEXTILE REQUESTS TO MAKE MARKET ACCESS A PRIORITY—WHILE U.S. GOVERNMENT DOUBLES ACCESS FOR ASIAN TEXTILE EXPORTERS

In 1994, as part of the Uruguay Round Agreements Act, the U.S. Government assured the domestic textile industry that it would get market access to lucrative Far Eastern markets that have been closed to U.S. textile exports for generations. The government also included in the legislation, punitive measures that were supposed

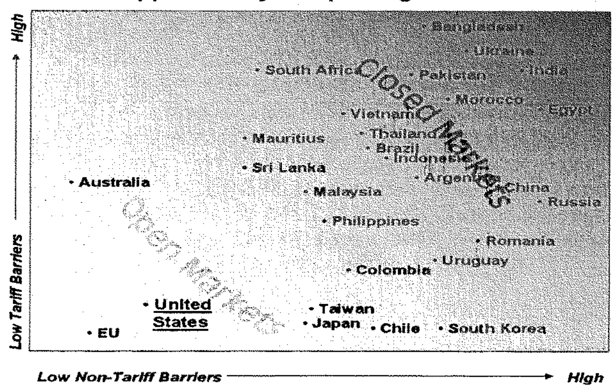
[1] "In bond" or "in transit" refers to goods that are supposed to be transiting U.S. territory but not entering U.S. commerce. U.S. Customs does not inspect these goods and electronically "wipes" entries once shipments supposedly exit U.S. territory. Smugglers take advantage of the lack of Customs oversight to send Asian goods "in transit"to Mexico but then to divert them while in the United States into U.S. commerce. The goods not only avoid quotas but duties as well.

[2] June 4th, 2001. For a copy of a press release and the letter, go to: *http://www.nam.org/tertiary.asp?TracklD=&CategorylD=1 &DocumentlD=23097.*

to be invoked if the major textile exporting countries in Asia continued to keep their markets closed.

Seven years later, not only have these market openings failed to materialize, but the U.S. Government has refused to take the punitive steps it promised against Asian exporters that continue to keep their markets closed. As a result, most of the textile exporting countries still block most or all U.S. textile exports from their markets[3].

Current Market Access Conditions For Textiles and Apparel: Major Exporting Countries



Thus, while the U.S. Government has doubled access to the U.S. textile market for Asian suppliers since 1994[4], it has gotten no new or compensating access to overseas markets for U.S. textile manufacturers. Repeated industry attempts to get the government to take action under various discretionary government vehicles, including the GSP clause, the market action provisions of the Agreement on Textiles and Clothing and Section 301 have met with almost total failure. In addition, industry attempts to get the government to list textile market access as a priority trade area have been repeatedly ignored.

4. COMMERCE DEPARTMENT: REGULATIONS HAMSTRING INDUSTRY IN ATTACKING ILLEGAL DUMPING AND SUBSIDIZATION—OTHER IMPORTANT TRADE REMEDIES ARE BLOCKED AS WELL

Since the Asian financial crisis caused Asian economies to go into recession, reports of dumping of textile products from Asia have been on the upswing. In particular, textile imports from China, Indonesia, Korea, Pakistan, and Thailand have been entering the United States at prices even below those that deflated Asian currencies could support.

However, in many instances, U.S. Commerce regulations prevent U.S. textile manufacturers from taking effective actions against dumped Asian goods. Under current U.S. dumping laws, Asian producers of dumped textile products can often make minor technical changes to their products in order reclassify them under a different tariff line and thereby avoid dumping margins.

In addition, countervailing duty (CVD) rules developed by the Commerce Department, which are aimed at illegal subsidies, are also limited in their effectiveness. The Commerce Department refuses to allow CVD cases to be brought against non-market economies, despite the fact that these economies often subsidize their exports to a much greater degree than market economies. In cases like China, government subsidies for state-owned textile mills—which have lost money in six out of the last 7 years—provide Chinese exporters with a large, and unfair, competitive edge. This situation will worsen when Vietnam, with its large state-owned sector, receives NTR tariff treatment.

ATMI would also like to note that. two important trade remedies, the 201 petition and imposition of category specific quotas, are also of limited use to the domestic

[3] For an in depth look at U.S. Government promises regarding market openings for U.S. textile products see "Promises Unkept: A Report on U.S. Textile Access" at *http://www.atmi.org/Promises.pdf.*

[4] The United States agreed as part of the Uruguay Round Agreements to progressively increase textile and apparel market access into the United States for Asian countries.

industry. A sector-wide 201 petition, which the Administration is pursuing on behalf of the domestic steel industry, should also be available to the domestic textile industry. However, the Uruguay Round Agreements Act denies the industry recourse to such a petition for products which are subject to quota coverage.[5]

In addition, in many instances over the past 5 years, textiles or apparel from WTO member countries have surged into the U.S. market. The U.S. Government has rarely established quotas on these products for fear of challenges by the WTO's Textile Monitoring Body (TMB), a non-binding review panel dominated by developing countries.

Since being formed in 1995, the TMB has erected voluminous new technical requirements for making a case for a new quota. These new TMB-imposed requirements are often impossible to meet in the United States[6] and, rather than protest their inequity, the U.S. Government has essentially stopped seeking new quotas despite record import surges over the last few years. In some cases, damaging surges have come from non-WTO countries. Such surges are quickly addressable through the use of Section 204 import quotas, which cannot be reviewed by the TMB. However, in some instances, the U.S. Government has refrained from acting despite the clear presence of market disruption in the United States.

GOVERNMENT ACTIONS URGENTLY NEEDED TO REBALANCE THE COMPETITIVE ARENA

During this time of economic crisis for the domestic industry, the U.S. textile industry needs its government to move swiftly to rebalance the competitive situation. Actions should include:

(A) Self-initiation by the U.S. Government of dumping and countervailing duty, escape clause or other unfair trade cases against Asian countries that are dumping into the U.S. market and illegally subsidizing their exports; or otherwise injuring U.S. textile producers and workers.

(B) A commitment by the U.S. Government not to lower textile and apparel tariffs during or prior to upcoming WTO negotiations.

(C) New, effective efforts by U.S. Customs to curb textile and apparel transshipments and smuggling, particularly those involving preferential duty claims and in-transit shipments.

(D) A comprehensive effort by the U.S. Government to open up the many markets that are still closed to U.S. textile products including the use of punitive actions against those countries that continue to block U.S. access.

(E) Quota calls—Regarding WTO member countries, the United States should challenge the TMB, not the other way round, regarding its impossible data requirements. The United States should move forward and introduce quota restraints wherever market disruption is occurring, regardless of TMB protestations. For non-WTO countries, the United States should use Section 204 to introduce restraints to the fullest extent possible against non-WTO countries.

(F) The United States should reject all attempts at the WTO by Asian textile exporting countries to speed up the quota phase-out schedule agreed to in the Uruguay Round or to liberalize other provisions of the Agreement on Textiles and Clothing. Recently, a number of these countries have pressed the Administration for new changes to the agreed upon rules and schedules governing textile and apparel trade in order to get yet more access to the U.S. market. These new efforts, coming from countries that continue to block U.S. textile access to their own markets and which have already enjoyed a doubling of their own access to the U.S. market, must be rejected.

In addition, ATMI urges the U.S. Government to abandon its strong dollar policy, which is putting into peril the livelihoods of hundreds of thousands of U.S. manufacturing workers across this country.

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[5] The Administration should consider initiating 201 actions in those instances, though limited, that it can be employed.

[6] Since the TMB requirements were imposed, the U.S. Government has required trade associations and groups to provide the additional data to meet the requirements. However, the American Apparel and Footwear Association, which consists mainly of apparel companies that import much more product than they produce in the United States, refuses to supply the data. As a result, the U.S. Government no longer imposes restraints against surging apparel imports from WTO members. Note that domestic textile industry companies that produce fabric for apparel have been hit the hardest of any textile sector by the recent surge from Asia.

NACFAM,
Washington, DC, June 28, 2001.

Hon. Ernest Hollings,
U.S. Senate,
Washington, DC.

DEAR SENATOR HOLLINGS: The Commerce Committee's hearing on the "Current State of American Manufacturing Industries" on June 21st raised a number of important issues and certainly is a welcome addition to the national dialog on manufacturing.

In concluding that hearing, you asked the panel to enumerate the most important issues facing manufacturing today. International trade, energy efficiency, interest rates, and health care costs, which were some of the issues mentioned, are certainly important, but we want to bring another to your attention—*Sustaining Productivity Growth.*

The industry-led National Coalition for Advanced Manufacturing (NACFAM) has long taken the position that the key to expanding prosperity is technology-driven productivity growth across all industry sectors. Higher productivity growth rates enable the economy to grow with higher wages but lower rates of inflation and unemployment—yielding Federal budget surpluses in the process.

In particular, the manufacturing sector drives national productivity growth. In the 1990's, manufacturing productivity growth far exceeded that of other sectors. Now that the rate of growth is beginning to slow, it is imperative that American manufacturers and the Federal Government invest in those areas needed to maintain continued advances in productivity.

NACFAM's Advanced Manufacturing Leadership Forum (AMLF) has conducted extensive research on the factors driving productivity growth over the last decade and policy actions needed to expand prosperity in the future. The AMLF, which includes leaders from industry, academia, and government, concluded that the economy is undergoing a major transformation-the fusion of the new economy with manufacturing-that is creating a second industrial revolution with enormous potential for expanding prosperity. In light of this momentous change in America's industrial capacity, the AMLF identified three key areas for policy action to support this industrial transformation:

1. Basic research investment to support the fundamental role of the U.S. private sector to produce and integrate the next generation of process and product technologies.

2. Workforce skills development to overcome extraordinary shortages of human capital and give American workers the tools needed to keep pace with rapid technological change.

3. Improving the performance of small and medium sized enterprises through enhanced technology adoption, extension services and software interoperability.

The findings were published in the White Paper: Smart Prosperity: An Agenda for Productivity Growth[1] The paper presents the roadmap for achieving a high productivity economy that can benefit all economic, regional and demographic sectors. To implement the agenda leadership roles for the private sector and government were defined (at all levels). We are confident that, if the recommendations are acted upon, they will enable even higher levels of productivity growth that will drive greater prosperity.

We welcome the opportunity to discuss these issues with you or your staff.

Sincerely,

ERIC MITTELSTADT,
Chairman, NACFAM,
Chairman Emeritus, Fanuc Robotics, NA.

LEO REDDY,
CEO & Founder, NACFAM.

EGILS MILBERGS,
President, NACFAM.

[1] The publication referred to is being retained in Committee files.

Prepared Statements of The Economic Policy Institute

NAFTA At Seven—It's Impact on Workers in All Three Nations

(By Jeff Faux)

Each year since the implementation of the North American Free Trade Agreement (NAFTA) on January 1, 1994, officials in Canada, Mexico, and the United States have regularly declared the agreement to be an unqualified success. It has been promoted as an economic free lunch—a "win-win-win" for all three countries that should now be extended to the rest of the hemisphere in a Free Trade Area of the Americas agreement.

For *some* people, NAFTA clearly has been a success. This should not be a surprise inasmuch as it was designed to bring extraordinary government protections to a specific set of interests—investors and financiers in all three countries who search for cheaper labor and production costs. From that perspective, increased gross volumes of trade and financial flows in themselves testify to NAFTA's achievements.

But most citizens of North America do not support themselves on their investments. They work for a living. The overwhelming majority has less than a college education, has little leverage in bargaining with employers, and requires a certain degree of job security in order to achieve a minimal, decent level of living. NAFTA, while extending protections for investors, explicitly excluded any protections for working people in the form of labor standards, worker rights, and the maintenance of social investments. This imbalance inevitably undercut the hard-won social contract in all three nations.

As the three reports in this paper indicate, from the point of view of North American working people, NAFTA has thus far largely failed.

These reports, based in part on more comprehensive labor market surveys in all three countries,[1] show that the impact on workers in each Nation has been different according to their circumstances. For example, given their respective sizes, the impact of economic integration has been inevitably greater in Canada and Mexico than in the United States. But despite this, there are striking similarities in the pattern of that impact.

In the United States, as economist Robert Scott details, NAFTA has eliminated some 766,000 job opportunities—primarily for non-college-educated workers in manufacturing. Contrary to what the American promoters of NAFTA promised U.S. workers, the agreement did not result in an increased trade surplus with Mexico, but the reverse. As manufacturing jobs disappeared, workers were downscaled to lower-paying, less-secure services jobs. Within manufacturing, the threat of employers to move production to Mexico proved a powerful weapon for undercutting workers' bargaining power.

Was U.S. workers' loss Mexican workers' gain? While production jobs did move to Mexico, they primarily moved to maquiladora areas just across the border. As Carlos Salas of La Red de Investigadores y Sindicalistas Para Estudios Laborales (RISEL) reports, these export platforms—in which wages, benefits, and workers' rights are deliberately suppressed—are isolated from the rest of the Mexican economy. They do not contribute much to the development of Mexican industry or its internal markets, which was the premise upon which NAFTA was sold to the Mexican people. It is therefore no surprise that compensation and working conditions for most Mexican workers have deteriorated. The share of stable, full-time jobs has shrunk, while the vast majority of new entrants to the labor market must survive in the insecure, poor-paying world of Mexico's "informal" sector.

As Bruce Campbell of the Canadian Centre for Policy Alternatives reports, Canada's increased market integration with the United States began in 1989 with the bilateral Free Trade Agreement, the precursor to NAFTA. While trade and investment flows increased dramatically, per capita income actually declined for the first 7 years after the agreement. Moreover, as in Mexico and the United States, Canadians saw an upward redistribution of income to the richest 20% of Canadians, a decline in stable full-time employment, and the tearing of Canada's social safety net.

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[1] The findings in this report grew out of work done in larger studies published in all three of the countries concerned. For more information on the U.S. labor market, see Lawrence Mishel, Jared Bernstein, and John Schmitt, *State of Working America, 2000–2001*, an Economic Policy Institute Book, Ithaca, N.Y.: ILR Press, an imprint of Cornell University Press, 2001.

For a detailed analysis of the Mexican labor market, see Alcalde Arturo, Graciela Bensusán, Enrique de la Garza, Enrique Hernández Laos, Teresa Rendón, and Carlos Salas, *Trabajo y Trabajadores en el México Contemporáneo,* México, D.F.: Miguel Angel Porrúa, 2000.

A recent analysis of the Canadian labor market can be found in Andrew Jackson and David Robinson, *Falling Behind: The State of Working Canada, 2000*, Ottawa, Ontario: Canadian Centre for Policy Alternatives, 2000.

This continent-wide pattern of stagnant worker incomes, increased insecurity, and rising inequality has emerged at a time when economic conditions have been most favorable for the success of greater continental integration. The negative effect of increasing trade and investment flows has been obscured by the extraordinary consumer boom in the United States, especially during the period from 1996 through the summer of 2000. The boom, driven by the expansion of domestic consumer credit and a speculative bubble in the stock market, spilled over to Canada and Mexico. Their economies have now become extremely dependent on the capacity of U.S. consumers to continue to spend in excess of their incomes. As the air seeps out of that bubble, the cost of those nations' reliance on the U.S. consumer market is becoming apparent.

The current imbalanced structure of NAFTA is clearly inadequate for the creation of an economically sustainable and socially balanced continental economy. The experience suggests that any wider free trade agreement extended to the hemisphere that does not give as much priority to labor and social development as it gives to the protection of investors and financiers is not viable. Rather than attempting to spread a deeply flawed agreement to all of the Americas, the leaders of the nations of North America need to return to the drawing board and design a model of economic integration that works for the continent's working people.

NAFTA'S HIDDEN COSTS—TRADE AGREEMENT RESULTS IN JOB LOSSES, GROWING INEQUALITY, AND WAGE SUPPRESSION FOR THE UNITED STATES

(By Robert E. Scott)

The North American Free Trade Agreement (NAFTA) eliminated 766,030 actual and potential U.S. jobs between 1994 and 2000 because of the rapid growth in the net U.S. export deficit with Mexico and Canada. The loss of these real and potential jobs[1] is just the most visible tip of NAFTA's impact on the U.S. economy. In fact, NAFTA has also contributed to rising income inequality, suppressed real wages for production workers, weakened collective bargaining powers and ability to organize unions, and reduced fringe benefits.

NAFTA's impact in the U.S., however, often has been obscured by the boom and bust cycle that has driven domestic consumption, investment, and speculation in the mid- and late 1990's. Between 1994 (when NAFTA was implemented) and 2000, total employment rose rapidly in the U.S., causing overall unemployment to fall to record low levels. Unemployment, however, began to rise early in 2001, and, if job growth dries up in the near future, the underlying problems caused by U.S. trade patterns will become much more apparent, especially in the manufacturing sector. The U.S. manufacturing sector has already lost 759,000 jobs since April 1998 (Bernstein 2001). If, as expected, U.S. trade deficits continue to rise with Mexico and Canada while job creation slows, then the job losses suffered by U.S. workers will be much larger and more apparent than if U.S. NAFTA trade were balanced or in surplus.

GROWING TRADE DEFICITS AND JOB LOSSES

NAFTA supporters have frequently touted the benefits of exports while remaining silent on the impacts of rapid import growth (Scott 2000). But any evaluation of the impact of trade on the domestic economy must include *both* imports and exports. If the United States exports 1,000 cars to Mexico, many American workers are employed in their production. If, however, the U.S. imports 1,000 foreign-made cars rather than building them domestically, then a similar number of Americans who would have otherwise been employed in the auto industry will have to find other work. Ignoring imports and counting only exports is like trying to balance a checkbook by counting only deposits but not withdrawals.

The U.S. has experienced steadily growing global trade deficits for nearly three decades, and these deficits have accelerated rapidly since NAFTA took effect on January 1, 1994. Although gross U.S. exports to its NAFTA partners have increased dramatically—with real growth of 147% to Mexico and 66% to Canada—these increases have been overshadowed by the larger growth in imports, which have gone up by 248% from Mexico and 79% from Canada, as shown in Table 1-1. As a result, the $16.6 billion U.S. net export deficit with these countries in 1993 increased by

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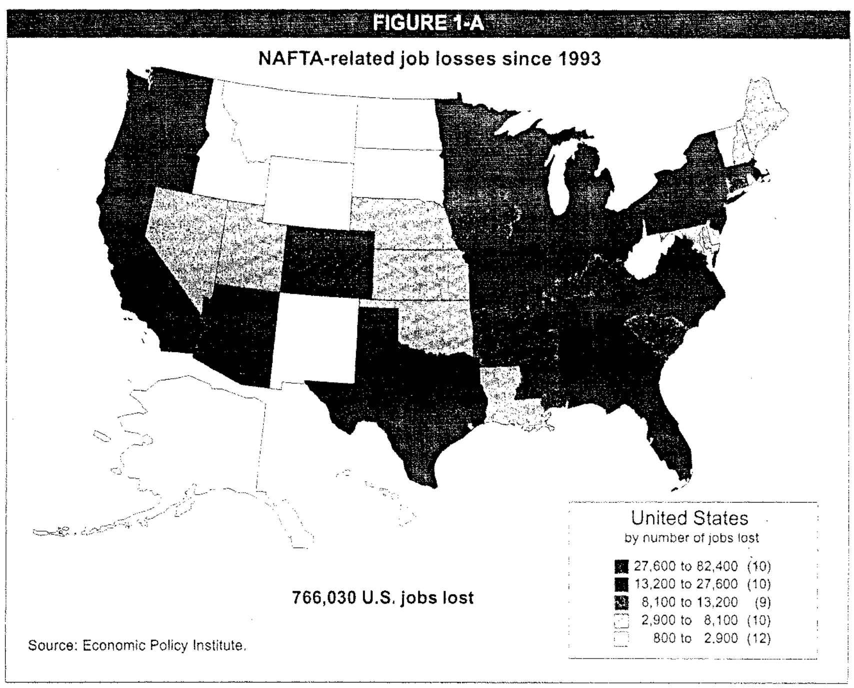
[1] Potential jobs, or job opportunities, are positions that would have been created if the trade deficit with Mexico and Canada had remained constant, in real terms (and holding everything else in the economy constant). The total number of jobs and job opportunities is a measure of what employment in trade-related industries would have been if the U.S. NAFTA trade balance remained constant between 1993 and 2000, holding everything else constant.

378% to $62.8 billion by 2000 (all figures in inflation-adjusted 1992 dollars). As a result, NAFTA has led to job losses in all 50 states and the District of Columbia, as shown in Figure 1-A.

Table 1-1.—U.S. Trade With Canada and Mexico, 1993–2000, Totals For All Commodities

[Millions of constant 1992 dollars]

	1993	2000	Change since 1993		
			Dollars	Percent	Jobs lost or gained
Canada					
Domestic exports	$90,018	$149,214	$59,196	66%	563,539
Imports for consumption	108,087	193,725	85,638	79	962,376
Net exports	(18,068)	(44,511)	(26,443)	146	(398,837)
Mexico					
Domestic exports	$39,530	$97,509	$57,979	147%	574,326
Imports for consumption	38,074	132,439	94,364	248	941,520
Net exports	1,456	(34,930)	(36,386)	n.a	(367,193)
Mexico and Canada					
Domestic exports	$129,549	$246,723	$117,174	90%	1,137,865
Imports for consumption	146,161	326,164	180,003	123	1,903,896
Net exports	(16,612)	(79,441)	(62,828)	378	(766,030)



The growing U.S. trade deficit has been facilitated by substantial currency devaluations in Mexico and Canada, which have made both countries' exports to the United States cheaper while making imports from the United States more expensive in those markets. These devalued currencies have also encouraged investors in Canada and Mexico to build new and expanded production capacity to export even more goods to the U.S. market.

The Mexican peso was highly overvalued in 1994 when NAFTA took effect (Blecker 1997). The peso lost about 31% of its real, inflation-adjusted value between 1994 and 1995, after the Mexican financial crisis. The peso has gained real value (appreciated) recently because inflation in Mexico has remained well above levels in the U.S. As prices in Mexico rose, its exports become less competitive with goods produced in the U.S. and other countries because the peso's market exchange rate was unchanged between 1998 and 2000. High inflation in Mexico also made imports cheaper, relative to goods purchased in the U.S.

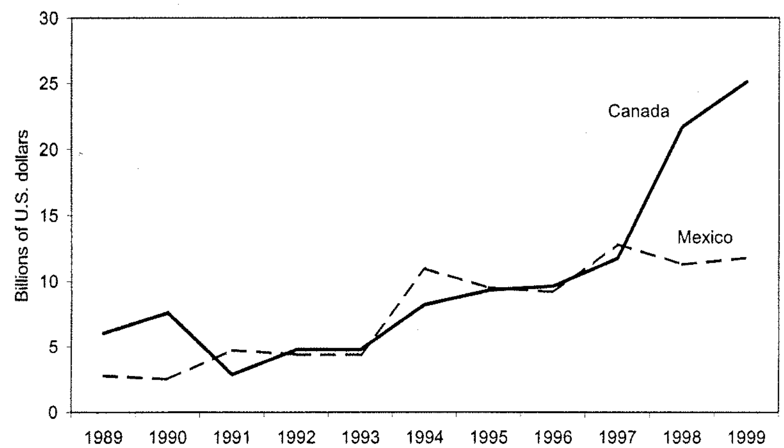
By 2000 the peso's real value had risen to roughly the pre-crisis levels of 1994.[2] Thus, the peso was as overvalued in 2000 as it was when NAFTA took effect. As a result, Mexico's trade and current account balances worsened substantially in 1998–2000, as imports from other countries surged, despite the fact that Mexico's trade surplus with the U.S. continued to improve through 2000. Given Mexico's large overall trade deficits, and the rising value of the peso, pressures are building for another peso crisis in the near future.

The Canadian dollar has depreciated over the past few years. The Canada-U.S. Free Trade Agreement—a precursor to NAFTA—took effect in 1989. Initially, the Canadian dollar rose 4.1% in real terms between 1989 and 1991, as Canada's Central Bank tightened interest rates. During this period, Canada maintained short-term interest rates that averaged 2.25 percentage points above those in the U.S. (1989 to 1994), which caused the initial appreciation in its currency. Canada then began to reduce real interest rates in the mid-1990's. Between 1995 and 2000, short-term interest rates in Canada were 0.75 percentage points below U.S. rates, a net swing of 3.0 percentage points. The Canadian dollar began to depreciate in the mid-1990's, as interest rates were reduced, relative to the U.S. Overall, between 1989 and 2000, the Canadian dollar *lost* 27% of its real value against the U.S. dollar.[3]

NAFTA and the devaluation of currencies in Mexico and Canada resulted in a surge of foreign direct investment (FDI) in these countries, as shown in Figure 1-B. Between 1993 and 1999 (the most recent period for which data have been published), FDI in Mexico increased by 169%. It grew rapidly between 1993 and 1997, following the peso crisis, and then declined slightly afterwards, because of the steady appreciation of Mexico's real exchange rate between 1995 and 2000.

FIGURE 1-B

Foreign direct investment in Canada and Mexico, 1989-2000



Source: Economic Policy Institute.

FDI in Canada more than quadrupled between 1993 and 1999, an increase of 429%, largely as a result of the falling value of the Canadian dollar in this period. Inflows of FDI, along with bank loans and other types of foreign financing, have funded the construction of thousands of Mexican and Canadian factories that produce goods for export to the United States. Canada and Mexico have absorbed more than $151 billion in FDI from all sources since 1993. One result is that the

[2] EPI calculations and International Monetary Fund (IMF) (2001).

[3] IMF (2001) and EPI calculations. This analysis compares overnight money market rates in Canada (annual averages) with the comparable Federal funds rate for the U.S.

U.S. absorbed an astounding 96% of Mexico's total exports in 1999.[4] The growth of imports to the U.S. from these factories has contributed substantially to the growing U.S. trade deficit and the related job losses. The growth of foreign production capacity has played a major role in the rapid growth in exports to the U.S.

NAFTA COSTS JOBS IN EVERY STATE

All 50 states and the District of Columbia have experienced a net loss of jobs under NAFTA (Table 1-2). Exports from every state have been offset by faster-rising imports. Net job loss figures range from a low of 395 in Alaska to a high of 82,354 in California. Other hard-hit states include Michigan, New York, Texas, Ohio, Illinois, Pennsylvania, North Carolina, Indiana, Florida, Tennessee, and Georgia, each with more than 20,000 jobs lost. These states all have high concentrations of industries (such as motor vehicles, textiles and apparel, computers, and electrical appliances) where a large number of plants have moved to Mexico.

Table 1-2.—NAFTA Job Loss By State, 1993–2000

State	Net NAFTA job loss[1]	State	Net NAFTA job loss[1]
Alabama	16,826	Missouri	16,773
Alaska	809	Montana	1,730
Arizona	8,493	Nebraska	4,352
Arkansas	9,615	Nevada	4,374
California	82,354	New Hampshire	2,970
Colorado	8,172	New Jersey	19,169
Connecticut	9,262	New Mexico	2,859
Delaware	1,355	New York	46,210
District of Columbia	1,635	North Carolina	31,909
Florida	27,631	North Dakota	1,288
Georgia	22,918	Ohio	37,694
Hawaii	1,565	Oklahoma	7,009
Idaho	2,768	Oregon	10,986
Illinois	37,422	Pennsylvania	35,262
Indiana	31,110	Rhode Island	7,021
Iowa	8,378	South Carolina	10,835
Kansas	6,582	South Dakota	2,032
Kentucky	13,128	Tennessee	25,419
Louisiana	6,613	Texas	41,067
Maine	3,326	Utah	5,243
Maryland	8,089	Vermont	1,611
Massachusetts	16,998	Virginia	16,758
Michigan	46,817	Washington	14,071
Minnesota	13,202	West Virginia	2,624
Mississippi	11,469	Wyoming	19,362
		Wisconsin	864
U.S. total			766,030

[1] Excluding effects on wholesale and retail trade and advertising.
Source: EPI analysis of Bureau of Labor Statistics and Census Bureau data.

While job losses in most states are modest relative to the size of the economy, it is important to remember that the promise of new jobs was the principal justification for NAFTA. According to its promoters, the new jobs would compensate for the increased environmental degradation, economic instability, and public health dangers that NAFTA brings (Lee 1995, 10–11). If NAFTA does not deliver net new jobs, it can't provide enough benefits to offset the costs it imposes on the American public.

LONG-TERM STAGNATION AND GROWING INEQUALITY

NAFTA has also contributed to growing income inequality and to the declining wages of U.S. production workers, who make up about 70% of the workforce. NAFTA, however, is but one contributor to a larger globalization process that has led to growing structural trade deficits and has shaped the U.S. economy and soci-

[4] Bureau of the Census (2000) and EPI calculations.

ety over the last few decades.[5] Rapid growth in U.S. trade and foreign investment, as a share of U.S. gross domestic product, has played a large role in the growth of inequality in income distribution in the last 20 years. NAFTA has continued and accelerated international economic integration, and thus contributed to the growing tradeoffs this integration requires.

The growth in U.S. trade and trade deficits has put downward pressure on the wages of "unskilled" (i.e., non-college-educated) workers in the U.S., especially those with no more than a high school degree. This group represents 72.7% of the total U.S. workforce and includes most middle- and low-wage workers. These U.S. workers bear the brunt of the costs and pressures of globalization (Mishel et al. 2001, 157, 172–79).

A large and growing body of research has demonstrated that expanding trade has reduced the price of import-competing products and thus reduced the real wages of workers engaged in producing those goods. Trade, however, is also expected to increase the wages of the workers producing exports, but growing trade deficits have meant that the number of workers hurt by imports has exceeded the number who have benefited through increased exports. Because the United States tends to import goods that make intensive use of less-skilled and less-educated workers in production, it is not surprising to find that the increasing openness of the U.S. economy to trade has reduced the wages of less-skilled workers relative to other workers in the United States.[6]

Globalization has reduced the wages of "unskilled" workers for at least three reasons. First, the steady growth in U.S. trade deficits over the past two decades has eliminated millions of manufacturing jobs and job opportunities in this country. Most displaced workers find jobs in other sectors where wages are much lower, which in turn leads to lower *average* wages for all U.S. workers. Recent surveys have shown that, even when displaced workers are able to find new jobs in the U.S., they face a reduction in wages, with earnings declining by an average of over 13% (Mishel et al. 2001, 24). These displaced workers' new jobs are likely to be in the service industry, the source of 99% of net new jobs created in the United States since 1989, and a sector in which average compensation is only 77% of the manufacturing sector's average (Mishel et al. 2001, 169). This competition also extends to export sectors, where pressures to cut product prices are often intense.

Second, the effects of growing U.S. trade and trade deficits on wages go beyond just those workers exposed directly to foreign competition. As the trade deficit limits jobs in the manufacturing sector, the new supply of workers to the service sector (displaced workers and new labor market entrants not able to find manufacturing jobs) depresses the wages of those already holding service jobs.

Finally, the increased import competition and capital mobility resulting from globalization has increased the "threat effects" in bargaining between employers and workers, further contributing to stagnant and falling wages in the U.S. (Bronfenbrenner 1997a). Employers' credible threats to relocate plants, to outsource portions of their operations, and to purchase intermediate goods and services directly from foreign producers can have a substantial impact on workers' bargaining positions. The use of these kinds of threats is widespread. A *Wall Street Journal* survey in 1992 reported that one-fourth of almost 500 American corporate executives polled admitted that they were "very likely" or "somewhat likely" to use NAFTA as a bargaining chip to hold down wages (Tonelson 2000, 47). A unique study of union organizing drives in 1993–95 found that over 50% of all employers made threats to close all or part of their plants during organizing drives (Bronfenbrenner 1997b). This study also found that strike threats in National Labor Relations Board union-certification elections nearly doubled following the implementation of the NAFTA agreement, and that threat rates were substantially higher in mobile industries in which employers can credibly threaten to shut down or move their operations in response to union activity.

Bronfenbrenner updated her earlier study with a new survey of threat effects in 1998–99, 5 years after NAFTA took effect (Bronfenbrenner 2000). The updated study found that most employers continue to threaten to close all or part of their operations during organizing drives, despite the fact that, in the last 5 years, unions

[5] Globalization includes rapid growth in imports, exports, and the share of trade in the world economy, and even more rapid growth in the international flows of foreign investment around the world. The term is also used to refer to the international convergence of rules, regulations, and even the social structure and role of government in many countries. This process is often viewed as a "race-to-the-bottom" in global environmental standards, wages, and working conditions.

[6] See U.S. Trade Deficit Review Commission (2000, 110–18) for more extensive reviews of theoretical models and empirical evidence regarding the impacts of globalization on income inequality in the U.S.

have shifted their organizing activity away from industries most affected by trade deficits and capital flight (e.g., apparel and textile, electronics components, food processing, and metal fabrication). According to the updated study, the threat rate increased from 62% to 68% in mobile industries such as manufacturing, communications, and wholesale distribution. Meanwhile, in 18% of campaigns with threats, the employer directly threatened to move to another country, usually Mexico, if the union succeeded in winning the election.

The new study also found that these threats were simply one more extremely effective tactic in employers' diverse arsenal for thwarting worker efforts to unionize. At 38%, the election win rate associated with organizing campaigns in which employers made threats was significantly lower than the 51% win rate where there were no threats. Win rates were lowest—32% on average—when threats were made during organizing campaigns involving more mobile industries, such as manufacturing, communications, and wholesale distribution. Among this last group, companies targeted for organizing are much likelier than they were in 1993–95 to be subsidiaries of large multinational parent companies with foreign operations, customers, and suppliers. The 30% win rate for organizing campaigns with these global multinational companies suggests that the existence of other sites in Latin America, Asia, or Africa serves as an unspoken threat of plant closing for many U.S. workers.

Bronfenbrenner (2000) described the impact of these threats in testimony to the U.S. Trade Deficit Review Commission:

> Under the cover of NAFTA and other trade agreements, employers use the threat of plant closure and capital flight at the bargaining table, in organizing drives, and in wage negotiations with individual workers. What they say to workers, either directly or indirectly, is if you ask for too much or don't give concessions or try to organize, strike, or fight for good jobs with good benefits, we'll close, we'll move across the border just like other plants have done before.[7]

In the context of ongoing U.S. trade deficits and rising levels of trade liberalization, the pervasiveness of employer threats to close or relocate plants may conceivably have a greater impact on real wage growth for production workers than does actual import competition. There are no empirical studies of the effects of such threats on U.S. wages, so such costs simply have been ignored by other studies of NAFTA.

NAFTA, GLOBALIZATION, AND THE U.S. ECONOMY

The U.S. economy created 20.7 million jobs between 1992 and 1999. All of those gains are explained by growth in domestic consumption, investment, and government spending. The growth in the overall U.S. trade deficit eliminated 3.2 million jobs in the same period (Scott 2000). Thus, NAFTA and other sources of growing trade deficits were responsible for a change in the composition of employment, shifting workers from manufacturing to other sectors and, frequently, from good jobs to low-quality, low-pay work.

Trade-displaced workers will not be so lucky during the next economic downturn. If unemployment begins to rise in the U.S., then those who lose their jobs due to globalization and growing trade deficits could face longer unemployment spells, and they will find it much more difficult to get new jobs. When trying to tease apart the various contributing causes behind trends like the disappearance of manufacturing jobs, the rise in income inequality, and the decline in wages in the U.S., NAFTA and growing trade deficits provide only part of the answer. Other major causes include deregulation and privatization, declining rates of unionization, sustained high levels of unemployment, and technological change. While each of these factors has played some role, a large body of economic research has concluded that trade is responsible for at least 15–25% of the growth in wage inequality in the U.S. (U.S. Trade Deficit Review Commission 2000, 110–18). In addition, trade has also had an indirect effect by contributing to many of these other causes. For example, the decline of the manufacturing sector attributable to increased globalization has resulted in a reduction in unionization rates, since unions represent a larger share of the workforce in this sector than in other sectors of the economy.

So, although NAFTA is not solely responsible for all of the labor market problems discussed in this report, it has made a significant contribution to these problems, both directly and indirectly. Without major changes in the current NAFTA agreement, continued integration of North American markets will threaten the prosperity of a growing share of the U.S. workforce while producing no compensatory benefits to non-U.S. workers. Expansion of a NAFTA-style agreement—such as the proposed Free Trade Area of the Americas—will only worsen these problems. If the U.S. econ-

[7] Bronfenbrenner (1999).

omy enters into a downturn or recession under these conditions, prospects for American workers will be further diminished.

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Methodology Used For Job-Loss Estimates

This study uses the model developed in Rothstein and Scott (1997a and 1997b). This approach solves four problems that are prevalent in previous research on the employment impacts of trade. Some studies look only at the effects of exports and ignore imports. Some studies include foreign exports (transshipments)—goods produced outside North America and shipped through the United States to Mexico or Canada—as U.S. exports. Trade data used in many studies are usually not adjusted for inflation. Finally, a single employment multiplier is applied to all industries, despite differences in labor productivity and utilization.[8] The model used here is based on the Bureau of Labor Statistics' 192-sector employment requirements table, which was derived from the 1992 U.S. input-output table and adjusted to 1998 price and productivity levels (BLS 2001a). This model is used to estimate the direct and indirect effects of changes in goods trade flows in each of these 192 industries. This study updates the 1987 input employment requirements table used in earlier reports in this series (Rothstein and Scott 1997a and 1997b; Scott 1996).

We use three-digit, SIC-based industry trade data (Bureau of the Census 1994 and 2001), deflated with industry-specific, chain-weighted price indices (BLS 2001b). These data are concorded from HS to SIC (1987) classifications using conversion tables on the Census CDs. The SIC data are then concorded into the BLS sectors using sector-plans from the BLS (2001a). State level employment effects are calculated by allocating imports and exports to the states on the basis of their share of three-digit, industry-level employment (BLS 1997).

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[8] Other studies—see California State World Trade Commission (1997), which finds 47,600 jobs created in California from increased trade with Canada alone—have allocated all employment effects to the state of the exporting company. This is problematic, because the production—along with any attendant job effects—need not have taken place in the exporter's state. If a California dealer buys cars from Chrysler and sells them to Mexico, these studies will find job creation in California. However, the cars are not made in California; so the employment effects should instead be attributed to Michigan and other states with high levels of auto industry production. Likewise, if the same firm buys auto parts from Mexico, the loss of employment will occur in auto-industry states, not in California.

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THE IMPACT OF NAFTA ON WAGES AND INCOMES IN MEXICO

(By Carlos Salas, La Red de Investigadores y Sindicalistas Para Estudios Laborales (RISEL))

Mexico is much changed in the 7 years since NAFTA was implemented in 1994. Although Mexico now has a large trade surplus with the U.S., Mexico has also developed a large and growing overall trade deficit with the rest of the world. In fact, Mexico's net imports from the rest of the world now substantially exceed its net exports to the United States. Official unemployment levels in Mexico are lower now than before NAFTA, but this decline in the official rate simply reflects the absence of unemployment insurance in Mexico. In fact, underemployment and work in low-pay, low-productivity jobs (e.g., unpaid work in family enterprises) actually has grown rapidly since the early 1990's. Furthermore, the normal process of rural-to-urban migration that is typical of developing economies has reversed since the adoption of NAFTA. The rural share of the population increased slightly between 1991 and 1997, as living and working conditions in the cities deteriorated.

Between 1991 and 1998, the share of workers in salaried[1] jobs with benefits fell sharply in Mexico. The compensation of the remaining self-employed workers, who include unpaid family workers as well as small business owners, was well above those of the salaried sector in 1991. By 1998, the incomes of salaried workers had fallen 25%, while those of the self-employed had declined 40%. At that point, the average income of the self-employed was substantially lower than that of the salaried labor force. This reflects the growth of low-income employment such as street vending and unpaid family work (for example, in shops and restaurants). After 7 years, NAFTA has not delivered the promised benefits to workers in Mexico, and few if any of the agreement's stated goals has been attained.

RUNNING HARD BUT FALLING BEHIND

Despite a quick recovery from the 1995 peso crisis and a peak 7% gross domestic product (GDP) growth rate in 2000 (Figure 2-A), NAFTA still has failed to help most workers in Mexico.

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[1] Most workers in Mexico are paid a daily wage, as opposed to the hourly wage paid in the U.S. These workers are referred to in Mexico's statistics as "salaried," or, more literally, "waged" employees. These terms refer to several different methods of payment (both daily and piece-work, for example). Thus, a salaried job in Mexico can be very different from one in the U.S.

FIGURE 2-A

Source: INEGI, Base de Información Económica, Febbruary 2001.

Although foreign direct investment (FDI) in Mexico has continued to grow, total investment actually declined between 1994 and 1999 (Table 2-1). The only types of investment that have grown since 1994 are the maquiladora industries, reinvested profits, and stock market investments. Speculative flows of financial capital into stock market investments, in particular, increased, but overall investment in Mexico fell between 1994 and 1999. These inflows help explain the rapid—and perhaps unsustainable—growth in prices on the Mexican stock market in the late 1990's.

Table 2-1.—Foreign Investment

[billions of U.S. dollars]

	1994	1999
Total foreign investment[1]	$19,045	$16,295
New investment	9,661	4,448
Profit reinvestment	2,336	2,627
Intrafirm investment	2,038	1,932
Investment in maquiladoras	895	2,778
Stock market investment	4,083	4,509

[1] Partials may not add to total due to rounding.
Source: VI Informe de Gobierno de Ernesto Zedillo, 2000.

Manufacturing exports, as officially reported, have improved rapidly since NAFTA took effect. From 1995 to 1999, these exports grew at an annual rate of 16%, due almost exclusively to "value added" exports in Maquiladora production.[2] The total value of these exports increased 19.7% annually, as the average value added of products exported from Mexico decreased (relative to their overall value). However, maquiladora exports contain a substantial share of imported components from the U.S. and other countries, reducing the net benefits of these exports to the Mexican economy and its development. Thus, the export growth and the foreign trade performance of the Mexican economy look better on paper than in reality. But even these benefits disappear when total imports are considered. Total manufacturing imports from the U.S. and the rest of the world grew 18.5% per year between 1995 and 1999, a fact that explains Mexico's rapidly growing overall foreign trade deficit in this period. In the long run, this process of economic growth with expanding foreign trade deficits could lead to another major currency crisis similar to the one that occurred in 1994 (Blecker 1996).

HOW STRONG WAS EMPLOYMENT GROWTH BETWEEN 1995 AND 1999?

Total employment in Mexico grew from 33.9 to 39.1 million jobs over the 1995–99 period (3.7% annually), according to officially reported data (INEGI 1995 and 1999). But these data must be used with some caution, because the sample used for the National Employment Survey changed in 1998. Comparing the 1998 and 1999 data provides a more realistic rate of employment growth. Total employment reported for 1998 was 38.6 million jobs, resulting in an actual rate of growth in 1999 of only 1.2%.

Total employment in Mexico must grow 2.5% in order to fulfill the yearly demand for 1.2 million new jobs (CONAPO 2000). Since GDP grew 3.7% in 1999, these data suggest that GDP should grow at about 7% annually to achieve a sustained 2.5% growth rate in employment and avoid rising unemployment. Yet Mexico has achieved a 7% rate of growth in only 1 year (2000) in the past decade.

Agricultural Employment Trends

Agricultural activities are still the most important single source of employment in Mexico. In 1999, agricultural employment (8.2 million workers) accounted for 21% of the total labor force. For the past 10 years, agricultural employment has hovered around eight million. This stability suggests that NAFTA did not lead to a major surge in migration trends from the countryside to the cities. Over the long term, steady growth in corn imports has helped stimulate a general migration process. This doesn't mean that most *campesinos*—traditional corn growers—will decide to remain in rural areas in the future. A major increase in rural-to-urban migration process could start sometime in the next decade if corn prices keep falling and no other sources of income generation are provided to *campesinos*.

Interstate migration patterns, however, remained unchanged in this period, which reinforces the idea that most corn growers still are cultivating their land plots (Nadal 2000). What is more remarkable is that there was a slight increase in the share of the population living in rural areas between 1991 and 1997.

Migration is another major alternative for Mexican workers who cannot find good jobs. Northbound international migration has increased all through the 1990's, and the number of permanent migrants, in particular, has been on the rise (Tuiran 2000). The geographical origin of these migrants is very diverse, as many of the new migrants come from regions with no previous history of migration flows to the United States. At the same time, more migrants are coming from urban areas and are better educated, which provides a stark contrast with the traditional image of rural, illiterate migrants. This shift in migration patterns is another significant indicator of a decline in the supply of good jobs in Mexico, even for well-educated workers.

Nonagricultural Employment Trends

Despite the increase in migration to the north, it appears that the rapid growth in Mexico's potential labor supply has been matched by a seemingly impressive rate of growth in nonagricultural occupations. On average, the number of employed has increased by slightly less than 1.3 million per year. The unemployment rate has, therefore, not shown any upward trend and has remained at a low level, with only short-term fluctuations as economic activity has varied. Unemployment in urban areas remained at very low levels of 2–3% between 1987 and 1999. The only major

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[2] Under U.S. tariff code provisions (HTS 9802), U.S. firms are allowed to send U.S.-made inputs abroad for assembly and then return those semi-finished or finished products to the U.S., paying a tariff only on value added abroad.

exception was in 1995, corresponding with the peso crisis, when overall unemployment surged above 6% and reached almost 14% for teenagers. Over 14 all, however, unemployment rates have been low by international standards, rarely exceeding 8% even for young people.

It would be misleading, however, to conclude from such steadily low unemployment measures that Mexico has avoided the difficulties that most market economies face of providing enough jobs. There are, in fact, clear explanations as to why the official unemployment measures are so low. Mexico's labor force statistics count someone as employed if that person has worked at least 1 hour in the week before the survey takes place, following ILO standards (Hussmans et al. 1990). Under this definition, a person is counted as employed regardless of whether the person only works half time for no pay in a family business or works full time in a modern manufacturing plant. But Mexico's low rate of open unemployment is not a statistical distortion—it primarily reflects the workings of a different labor market structure.[3] Given that a large proportion of the population has no capacity for saving, and that there is no unemployment insurance, open unemployment in Mexico is, to paraphrase Gunnar Myrdal, a luxury few can afford.

Not surprisingly, unemployment rates are clearly higher for the most educated, who have higher incomes and greater savings capacity. But for those at the bottom of the wage scale, being "employed" does not guarantee an adequate standard of living, especially given the broad definition of what constitutes employment in the Mexican labor market. Deteriorating labor market conditions in Mexico have thus resulted in a decline in the quality of jobs rather than increases in unemployment rates, as might be the case in other economies with effective social safety nets.

The inability of the Mexican economy to create good quality jobs reflects two primary trends: a virtual halt in the process of urbanization, and the large and growing share of workers holding low-productivity, low-paying jobs in urban areas. While the economy was reducing the relative number of workers occupied in agricultural activities between 1970 and 1990, the past decade witnessed a reversal of this trend. Modernization of the economy, crudely defined as a declining share of rural and agricultural activities in the economy, was stagnant during most of these years. In spite of deficiencies in sampling and comparability of national employment surveys, the available data clearly show that, in the 1990's, the share of the labor force in less-urbanized areas and the share engaged in agricultural activities have both remained roughly constant at around 50% and 20–25%, respectively (INEGI-ENE 1991 and 1997).[4]

The deteriorating labor market conditions in the most important cities are reflected by an increase in the proportion of workers who are either self-employed or work in businesses with less than five employees. These low productivity jobs usually offer low pay. The share of the self-employed in total employment between 1987 and 1999 is shown in Table 2-2. The most important trend in urban employment in Mexico is the growth in service sector employment, as is happening in most economies. Rapid employment growth (and production) in trade and service industries poses two problems for the Mexican economy. Unlike service sector jobs in developed economies, Mexico's non-industrial activities do not include a strong and dynamic sector of high value-added services. Even in the case of the growing employment in financial service activities—a process clearly associated with privatization and new investments—a large part of this expansion can be attributed to continued protection and the absence of regulation (but not to the spread of highly competitive, world-class services). Thus, wages and productivity in these industries are low, by world standards.

Table 2-2.—Labor Structure In Urbanized Areas, 1991–98

	1991	1998
Owner	4.8%	4.0%
Self-employed	16.6	22.8
Waged	73.9	61.2
Unpaid	4.6	12.0

[3] The condition of open unemployment includes "frictional" unemployment, that is, people who know for sure or firmly believe they will be hired in the near future (Rendon y Salas 1993). For further discussion of measures of Mexico's unemployment see, for example, Fleck and Sorrentino (1994).

[4] The share of less-urbanized areas was 52.6% in 1991 and 53.6% in 1997. The share in agriculture was 23.6% in 1991 and 24.1% in 1997 (derived from INEGI-ENE 1991 and 1997).

Table 2-2.—Labor Structure In Urbanized Areas, 1991–98—Continued

	1991	1998
Other	0.1	0.1
Total	100.0	100.0

Source: Calculations based on data files from INEGI's Encuesta Nacional de Empleo (ENE), 1991 and 1998.

Mexico's service sector growth is characterized by extreme heterogeneity, running the gamut from single-person activities such as street vending to stock market brokering using the latest technologies and facilities. Furthermore, unlike the newly industrialized countries of Asia, Mexico's adoption of an economic strategy that relies on sustained growth in manufacturing exports—facilitated by its close geographic proximity to the U.S.—has not increased the share of manufacturing employment in the economy.

As a result of these trends, the structure of the urban labor landscape has changed in important ways in the 1990's. The most important shift is the diminishing share of regular salaried occupations in total employment. Between 1991 and 1998, the share of salaried employees in total employment decreased by 13 percentage points, from 73.9% to 61.2%. The resulting void was filled by either informal employment activities or simple unemployment. The share of self-employed workers increased by 50%, and the share of workers having unpaid positions as their first occupation doubled (as shown in Table 2–2).

Older salaried workers apparently switched to self-employed occupations, while younger workers were even less fortunate, moving into unpaid positions or becoming unemployed in this period. The share of workers aged 12 to 14 that had unpaid positions jumped from 40% to 60% between 1991 and 1998. The reduction in salaried occupations has cut across most industries. However, there are significant differences between those industries. A high proportion of nonsalaried jobs in the labor market indicates a backward production structure. For example, retail trade, food, transportation, and accommodations have among the largest shares of self-employed and unpaid workers. The high rate of nonsalaried jobs in these industries reflects the large presence of small firms and relative simplicity of the tasks performed by the workers in those jobs. Comparing 1991 and 1998, the loss of salaried occupations was almost completely offset by the growth in self-employed and unpaid workers.

Traditional manufacturing activities show the sharpest relative reductions in the shares of salaried workers, with the modern manufacturing, construction, trade, and communications industries being the next largest losers of salaried jobs. These changes are partially explained by the effects of the 1995 crisis upon traditional types of production in manufacturing and other industries, but they also reflect long-term segmentation trends in labor markets.

The growing share of self-employed workers means that people moved to deteriorating labor occupations. Wages decreased by 27% between 1991 and 1998, while overall hourly income from labor decreased 40%. Thus, labor income for the self-employed was cut in half in this period (Table 2-3). Average self-employment incomes fell from 17% above salaried worker incomes in 1991 to 19% below in 1998. In real terms, the relative well-being of the self-employed did not decrease as much as suggested by income comparisons, but this is far from reassuring. Reductions in real wages do not entirely explain the, deterioration of labor conditions. During the same period, the share of salaried workers receiving fringe benefits also fell systematically, as shown in Table 2-4.

Table 2-3.—Mean hourly income from labor, 1991–98 (1993 pesos)

	1991	1998	Percent change
Owner	20.53	10.71	–47.8
Subcontractors	12.47	n.a.	n.a.
Self-employed	7.71	3.89	–49.6
Co-operatives	4.22	7.01	66.2
Salaried	6.57	4.83	–26.6
Salaried, by piece or percentage	8.31	4.40	–47.0
Other	6.12	n.a.	n.a.
All	7.04	4.22	–40.0

Source: Author's calculations based on data files from INEGI's Encuesta Nacional de Empleo (ENE), 1991 and 1998.

Table 2-4.—Share of salaried workers with fringe benefits in urban areas (percent)

	1991	1998
End-of-the-year bonus	62.7	54.5
Participation in profits	19.2	15.4
Paid holidays	59.3	50.4
Credit for housing	13.3	21.8
Health insurance (IMSS)	45.5	42.7
Health insurance (ISSSTE)	7.0	4.6
Private health	12.5	9.3

Source: Author's calculations based on ENE data files, 1991 and 1998.

The maquiladora sector's employment performance contrasts significantly with that of Mexico's other large manufacturing plants. The maquiladora sector began as a program for in-bond processing plants, primarily making goods for re-export in Mexico's northern border cities. These plants employed an industrially inexperienced labor force to perform simple assembly tasks in traditional manufacturing. Maquiladoras have evolved over time, but they have remained largely isolated from the rest of the Mexican economy. Maquiladora employment grew rapidly, from 60,000 workers in 1975 to 420,000 in 1990. The pace of job creation slowed somewhat in the early 1990's, but it accelerated again after the 1994–95 peso devaluation. In 2000, maquiladora industries employed 1.3 million workers, concentrated mostly in electrical and electronic products, auto parts, and apparel and textiles. Employment in those activities accounts for more than 80% of total manufacturing employment in the maquiladora plants (Table 2-5).

Table 2-5.—Employment in Selected Maquiladora ctivities In 2000

	Employment
Electric and electronic parts and components	335,668
Apparel and textiles	281,866
Transportation equipment and parts	237,004
Electric and electronic apparatus and appliances	104,262
Other manufacturing activities	142,805

Source: Base de Información Económca, INEGI.

Maquiladoras have helped offset weak job creation in other domestic manufacturing industries,[5] accounting for about 13% of total manufacturing employment in 1995 and almost 16% in 1999. Maquiladora plants contributed 35% of all new manufacturing employment between 1995 and 1999. Most of the remaining jobs created during this period were in small non-maquiladora plants (Alarcón and Zepeda 1997, 1998).

The 1995 recession's impact on maquiladora plants was relatively mild, which is not surprising given their nearly complete specialization in export production.[6] Maquiladora job growth accelerated between 1995 and 1997, adding 150,000 positions each year during this 3-year period. This sum far exceeds the 60,000 jobs added each year between 1987 and 1989. Employment in maquiladora apparel production rose rapidly from 1995 to 1997, a fact closely linked to the relaxation of the Multifibre Agreement quotas after the implementation of NAFTA (O'Day 1997). Maquiladora jobs in electronics and auto part exports expanded as well, in keeping with those industries' global strategies (Carrillo and Gonzalez 1999).

There were also important regional changes as maquiladora plants were established in cities far from the Mexico-U.S. border. Between 1994 and 1999, the proportion of maquiladora workers in non-border locations increased from 16% to 22% as maquiladora production began shifting southward to sites such as Jalisco, the State of Mexico, Mexico City, Puebla, and Yucatan. Apparel-producing maquiladora plants, in contrast, moved to areas where compliance with labor laws is low, such as the states of Puebla and Morelos.

[5] Prior to the 1994–95 economic crisis, domestic-oriented and export-oriented manufacturing plants were approximately even in terms of employment creation. However, the 1994–95 devaluation of the peso gave exporters a boost, and maquiladora employment rose faster than in domestic-oriented producers.

[6] In fact, short-term economic or political events appear to have little effect on maquiladora activities.

DECLINING WAGES

Most directly employed workers have seen a steady erosion of their wages in the 1990's. In the last decade, the minimum wage in Mexico lost almost 50% of its purchasing power. The minimum wage is set each year through a process that includes consultations between official unions, employers, and the Federal Government. Currently the minimum wage is just a reference point for the wage bargaining process of wage and salary workers, and wages are usually set above this level in negotiated contracts.

Labor income in industries whose wage bargaining processes are under Federal supervision (the so-called *salarios contractuales* or contractual wages) lost almost more than 21% of their purchasing power between 1993 (the year before NAFTA took effect) and 1999 (Table 2-6). Manufacturing wages also declined by almost 21% in this period, and the purchasing power of the minimum wage fell 17.9% through 1999. The decline in real wages since NAFTA took effect helps explain the decline in labor incomes (see Table 2–3).

Table 2-6.—Wages in Mexico, 1990–99 (1990 = 100)

Year	Mimimum wage	Contractual wage	Wages in manufacturing
1990	100.00	100.00	100.00
1993	67.50	84.90	111.40
1994	65.80	81.50	105.20
1995	81.10	85.50	88.70
1996	66.50	76.60	81.20
1997	58.90	68.20	82.90
1998	56.90	66.50	85.70
1999	55.40	66.80	88.40
Change, 1993–99	–17.9%	–21.3%	–20.6%

Source: 6° Informe de gobierno de Ernesto Zedillo, 2000.

CONCLUSION

The decline in real wages and the lack of access to stable, well-paid jobs are critical problems confronting Mexico's workforce. While NAFTA has benefited a few sectors of the economy, mostly maquiladora industries and the very wealthy, it has also increased inequality and reduced incomes and job quality for the vast majority of workers in Mexico. In many ways (such as the stagnation of the manufacturing share of employment), the entire process of development has been halted, and in some cases it even may have been reversed. NAFTA has created some of the most important challenges for Mexico's development in the 21st century. The question that remains is whether Mexico can, under NAFTA, restart its stalled development and find a way to redistribute the benefits of the resulting growth.

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False Promise—Canada In The Free Trade Era

(By Bruce Campbell, Canadian Centre for Policy Alternatives)

It has been 12 years since the Canada-U.S. Free Trade Agreement was implemented and 7 years since it was renegotiated, extended to Mexico, and renamed NAFTA, the North American Free Trade Agreement. And NAFTA is now the template for the Free Trade Area of the Americas (FTAA) initiative), for which presidents and prime ministers from the hemisphere were scheduled to meet in Quebec City in April 2001 to set a course for its completion by 2005.[1]

"[F]ree trade agreements are designed to force adjustments on our societies," says Donald Johnston, former Liberal government minister and head of the Organization for Economic Cooperation and Development (quoted in Crane 1997a). His words display a candor rare among free trade proponents. Indeed, major adjustments have taken place in the Canadian economic and social landscape since the government promised a new dawn of prosperity in 1989, when the FTA went into effect:

- Trade with the U.S. has expanded dramatically during these 12 years. Canada's exports are now equivalent to 40% of its gross domestic product, up from 25% in 1989. (More than half of Canadian manufacturing output now flows south of the border, and Canadian producers account for less than half of domestic demand). This north-south trade boom has been mirrored by a relative decline in trade within Canada. Trade has also become more concentrated with the U.S.—from 74% to 85% of exports—and less concentrated with the rest of the world. Two-way investment flows have also increased greatly. Both Canadian foreign direct investment and portfolio flows to the U.S. grew much faster than did U.S. flows to Canada during this period.
- Growth performance in the 1990's was worse than in any other decade of the last century except the 1930's. Average per capita income fell steadily in the first 7 years of the decade and only regained 1989 levels by 1999. By comparison, per capita income in the U.S. grew 14% during this period (Sharpe 2000).
- Canada has become a noticeably more unequal society in the free trade era. Real incomes declined for the large majority of Canadians in the 1990's; they increased only for the top fifth. Employment became more insecure and the social safety net frayed.
- While productivity has grown—rapidly in some sectors—wages have not, a trend mirroring the delinking that has taken place in the U.S. But the overall productivity gap with the U.S. has not narrowed as free trade proponents predicted; rather, it has widened recently.
- Successive waves of corporate restructuring—bankruptcies, mergers, takeovers, and downsizing—have been accompanied by public sector restructuring—downsizing, deregulation, privatization, and offloading of State responsibilities. Public sector spending and employment have declined sharply, and publicly owned enterprises in strategic sectors such as energy and transportation have been transferred *en masse* to the private sector.

FTA and NAFTA boosters did not promise vague social adjustments, however; they sold the agreements based on rising productivity and rising incomes. By this standard the treaties have clearly not delivered, and their proponents can only offer the weak defense that things would have been worse in the absence of the agreements. Workers and policymakers in the FTAA countries may want to take the Canadian experience into account before buying into these unproved promises.

THE CANADIAN LABOR MARKET DURING THE FREE TRADE ERA

As noted above, exports to the U.S. have grown rapidly during the FTA/NAFTA era. Imports from the U.S. have also grown but not as quickly, resulting in a grow-

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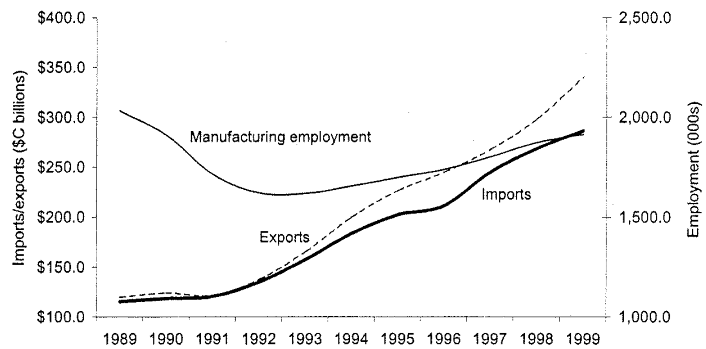
[1] Data cited in this paper are drawn directly or indirectly from various Statistics Canada documents: *Labour Force Survey, Employment Earnings and Hours, Canada's Balance of Payments, Survey of Consumer Finances, Income Distribution by Size, and Canadian Economic Observer.*

ing trade surplus (Figure 3-A).[2] The average annual trade surplus was $C19.7 billion during the 1990's, more than double the $C9.4 billion average in the 1980's. Canada's current account surplus with the U.S., which includes net payments to U.S. investors, was also positive albeit much lower, averaging $C6 billion annually. Here too, though, it was a lot higher than in the 1980's when the bilateral current account was roughly in balance.

FIGURE 3-A

Canada-U.S. exports and imports and manufacturing employment



Source: Statistics Canada, Employment Earnings and Hourings, annual estimates 1987-99; Canada's Balance of Payments, first quarter 1997, third quarter 2000.

Manufacturing employment bore the brunt of corporate restructuring, most severely in the first wave (1989–93), falling by 414,000 or 20% of the workforce. (The number of manufacturing establishments fell by 19% during 1988–95). High-tariff sectors were especially hard hit—leather experienced a 48% drop in employment, clothing 31%, primary textiles 32%, and furniture 39%. But employment was also slashed in medium-tariff sectors, such as machinery (32%) and electrical and electronic products (28%). By the end of the decade manufacturing employment was still 6% below its 1989 level. Employment in clothing, for example, was still 26% below 1989, and electrical/electronics was down 19%. Wages were flat or falling even in the so-called winning export sectors.

Unemployment in the 1990's averaged 9.6% compared to the U.S. rate of 5.8%—a doubling of the gap compared to the 1980's (Sharpe 2000). This level of unemployment was higher than in any other decade since the 1930's. While average worker earnings were stagnant, casualized (or nonstandard) employment exploded, as people struggled to cope during the prolonged slump and restructuring.

Paid full-time employment growth for most of the decade was almost nonexistent (Jackson and Robinson 2000). The absolute number of full-time jobs did not recover its 1989 level until 1998. Self-employment skyrocketed, accounting for 43% of new job creation between 1989 and 1999. Part-time employment accounted for another 37% of net employment growth during 1989–99. More than half of this growth was involuntary—due to the inability of people (mainly women) to find full-time work. Temporary work grew from 5% to 12% of total employment during the first half of the decade. Labor force participation rates dropped sharply, and at the end of the decade they were still well below their 1989 rates.

Evidence that the trade expansion and economic integration under NAFTA have had adverse employment effects in Canada comes from the government itself, in the form of a little-known study commissioned by Industry Canada.

The authors, Dungan and Murphy (1999), found that, while business sector exports grew quickly, import growth also kept pace. At the same time, the import content per unit of exports also grew markedly, while the domestic content per unit of exports fell.

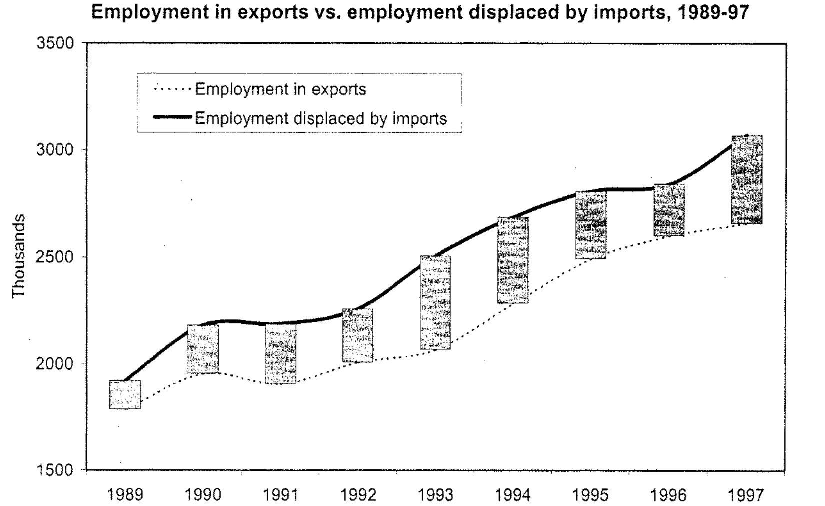
[2] Despite the dramatic increase in the share of total economic output accounted for by exports, the share of total employment accounted for by exports grew much more slowly (Dungan and Murphy 1999), due mainly to the increased import content of exports. Dungan and Murphy also observe that there was almost no growth in labor productivity in the export sector. It should also be noted that the proportion of imported inputs in Canadian exports is much higher than the proportion of imported inputs in American exports.

What did this mean for jobs? Employment (direct and indirect) in export industries rose from 19.6% of total business sector employment in 1989 to 28.3% in 1997. However, the rapid rise in imports displaced (or destroyed) even more employment. The job-displacing effect of imports rose steadily from an equivalent of 21.1% of total business employment in 1989 to 32.7% in 1997. The authors conclude: "imports are displacing 'relatively' more jobs than exports are adding" (Dungan and Murphy 1999).

What did this mean in terms of actual jobs created and destroyed? It is a simple matter to derive these numbers from Dungan and Murphy's data (see Figure 3-B). The result is striking. Between 1989 and 1997, 870,700 export jobs were created, but during the same period 1,147,100 jobs were destroyed by imports. Thus, Canada's trade boom resulted in a net destruction of 276,000 jobs.

FIGURE 3-B

Employment in exports vs. employment displaced by imports, 1989-97



Source: Dungan and Murphy (1999).

With this evidence, we can say more convincingly than ever that the conventional wisdom propagated by the business and political elites—that the trade expansion under NAFTA has meant a jobs bonanza for Canada—is false. On the contrary, trade expansion caused, at least in the first 8 years of free trade, a major net *destruction* of jobs.

The study also found that the labor productivity of the jobs displaced by imports was moderately lower than that of exports, though the productivity of these displaced jobs was still higher than the average productivity level for the business sector as a whole. This the authors see as beneficial for the economy as whole.

However, the positive spin on the study's findings is premised on the existence of macroeconomic policies whose priority is creating full employment conditions and on the expectation that displaced workers will find other jobs, and that those jobs will be at higher levels of productivity and income. There are three problems with these assumptions. First, it is not clear that these displaced workers are, by and large, finding higher productivity jobs elsewhere in the economy. In fact, to the extent that they are finding jobs outside the tradable sector, the jobs they find are likely at lower levels of productivity. Second, workers both in the tradable sectors and in the economy generally have not seen productivity growth translate into income gains. Third, and most importantly, macroeconomic policy in the 1990's (as will be described shortly) has not focused on employment creation. Rather, policymakers have focused on ultra low inflation and wage control to enhance business competitiveness under NAFTA. Unemployment since the grim 1990's has lately fallen to around 7%, but this is still far above the 5.4% average unemployment rate for the entire three decades from 1950 to 1980.

As for incomes, market income collapsed for low-income earners and inequality widened, most strikingly during the first half of the decade. Market incomes of the bottom 10% of families with children fell an astounding 84% during 1990–96, and those of the next 10% fell 31% (Yalnizyan 1998). But the restructuring and the massive labor market failure was offset by public transfers, keeping the overall distribution of income after taxes and transfers stable for a while. The consequent accumulation of fiscal deficits become politically unpalatable, though, and the government's ensuing "war on the deficit" provided the rationale for the social cuts that resulted in a widening of overall income inequality in the latter half of the decade—the first such widening in the postwar era. (Inequality in Canada still remains much lower in the United States.)

The top 20% of families increased their share of market income from 41.9% to 45.2% during 1989–98, while the bottom 20% saw their share drop from 3.8% to 3.1% (Robinson 2001). Even after taxes and transfers, the bottom 40% of families saw their inflation-adjusted income fall by close to 5% during 1989–98. The next 40% saw almost no change in their incomes. Only the top 20% saw a significant gain in per capita disposable income, an increase of 6.6%.

These have been difficult times for Canadian unions as well. The waves of layoffs and plant closures and the threat of closures in heavily unionized manufacturing sectors cut into their numbers: unionization rates in manufacturing fell from 35.0% to 33.4% during 1988–92. Years of defensive bargaining have resulted in unions' inability to appropriate a share of productivity increases for their members. This, too, signals an erosion of labor's bargaining power. And yet, despite the disastrous labor market conditions in manufacturing and throughout the economy, despite negative changes in labor laws and employment standards in some provinces, total union membership (not just in manufacturing) has remained remarkably stable: the overall unionization rate slipped only slightly from 32.0% of the paid workforce in 1987 to 30.7% in 1998 (Jackson and Robinson 2000).

NAFTA'S ROLE

To what extent should NAFTA take credit (or blame) for these changes? It is impossible to examine NAFTA in isolation from the broad anti-government and proderegulation policy agenda that has for the last two decades been transforming national economies and restructuring the roles and relationships among governments, markets, and citizens in the push to create an integrated global market economy. As a cornerstone of this well-known neoliberal family of policies—privatization, deregulation, investment and trade liberalization, public sector cutbacks, tax cuts, and monetary austerity—NAFTA has made it easier for Canadian policymakers to bring about a "structural adjustment" of the economy in line with the dominant U.S. model. Advancing and entrenching these policies in a treaty has secured investor rights, reined in interventionist government impulses and bargaining table demands of labor, and provided insurance against future governments' backsliding.

These policies have had, with some exceptions, an adverse impact on the employment and income conditions of working people in Canada. This is not an unintended consequence since, in essence, these policies transfer power from workers to management and investors, from wages to profits, from the public sector to the market.

But assessing causality is a complex task. Outcomes are the result of policies interacting with each other in mutually reinforcing ways. They are shaped by technological forces, corporate strategies, and a varied landscape of social and labor market institutions. NAFTA and its siblings have put downward pressure on employment and income conditions, but their impact varies from country to country, from sector to sector, from province to province depending on the strength of social and labor market institutions and the commitment of governments to either counter or reinforce these pressures. To be sure, policy choices do exist, but their range is more constrained, and with each turn of the "free market" screw the NAFTA legal framework makes it more difficult and often impossible to go in the other direction. For all these reasons isolating NAFTA impacts is exceedingly difficult.

The key provisions of the agreement itself that directly or indirectly affect product or labor markets are a good place to start. NAFTA removes tariffs and other nontariff barriers on all goods and services, thus impeding governments' ability to protect strategic or vulnerable sectors from import competition. These tariff restrictions also prevent governments from granting tariff or duty waivers to foreign multinationals in exchange for commitments to strengthen domestic capacity and employment.

NAFTA's most important provisions apply to investment. The treaty entrenches a set of rules protecting private property rights of investors, and virtually all types of ownership interests, financial or non-financial, direct or indirect, actual or potential, are covered. NAFTA liberalizes investment, enhancing its ability to operate less hampered by non-commercial considerations and reducing the risk of future governments unilaterally imposing new conditions on investment.

The very broad national treatment provisions of NAFTA oblige each member country to treat foreign investors exactly the same as it treats its own national investors, regardless of their contribution to the national economy. These provisions create an impetus for powerful alliances between foreign and domestically owned businesses to promote further deregulation and resist new regulation, since any policy to regulate foreign capital has to be applied equally to national capital. They remove important industrial policy tools, from local sourcing to technology transfer—tools that seek to channel foreign investment to strengthen domestic industrial capacity, create jobs, etc.

NAFTA prevents governments from regulating the outflow as well as the inflow of capital. It prevents governments from placing restrictions on any kind of cross-border financial transfer, including profits, dividends, royalties, fees, proceeds of sale of an investment, and payments on loans to subsidiaries. It also prevents governments from restricting the transfer of physical assets and technologies. While NAFTA claims to break down international protections and barriers, it provides strong intellectual property protection (patent, copyright, trademark, etc.) for corporations' technology. This is another instance of taking power out of the public realm and empowering corporations.

NAFTA limits the ability of state-owned enterprises to operate in ways that are inconsistent with commercial practice and in ways that impair benefits expected by private investors of the other NAFTA countries. This clearly affects the ability of public enterprises to pursue public policy goals that may override commercial goals. It also limits the ability of future governments to re-regulate or re-nationalize industries once they have been deregulated or privatized. It provides the legal framework for greater private penetration into traditionally public areas, notably health care and education.

Finally, NAFTA guarantees investors the right to prompt compensation at "fair market value" for measures that are deemed to be "tantamount to expropriation"—a vague term for measures that are seen in some way to impair commercial benefits, including any future benefits that might be expected. Claims under these and other provisions may be adjudicated through various dispute panels, including an investor-state disputes tribunal, where in recent years a flurry of corporate challenges have forced governments to reverse policy decisions. The likelihood of these kinds of challenges is putting a chill on any policy or regulation that might be perceived as an infringement of investor rights.

Under these rules of continental integration, considerations of competitiveness tend to trump all other policy considerations. In Canada this dynamic has had three major impacts:

- *Corporations cut costs, restructure.* On the corporate level, Canadian companies rationalize their cost cutting and restructuring through takeovers, downsizing, closure, and relocations as the only means to stay competitive against their NAFTA partners. Increased competition also intensifies the pressure on employers to demand worker concessions. Workers (except certain elite categories) are legally confined by national borders. Capital has the upper hand, since it can move more easily under the new regime or threaten to move if labor does not make wage and other concessions. It also increases the pressure to lower costs through production and work reorganization, leading to the increased use of part-time, temporary, and contract workers and outsourcing to non-union firms in low-wage jurisdictions.
- *The government adds corporate breaks, drops worker and environmental protections.* The Canadian government is shifting its fiscal and regulatory policies in order to be more competitive under NAFTA. This translates to raising subsidies while lowering taxes, regulations, and standards to maintain and attract investment. There are no *common* rules governing acceptable and unacceptable subsidies or limiting subsidy wars among governments. And labor and environmental side agreements, which purport to limit the competitive bidding-down of labor and environmental regulations, are ineffectual. Policy levers such as performance requirements and (conditional) tariffs, which aim to nudge investors in accordance with public policy priorities, have been largely removed. Thus, the need to provide incentives to attract investment has created dual stresses—downward pressure on regulations and upward pressure on government spending.
- *Macro policy tilts to capital, away from labor.* The macroeconomic policy priorities and choices, especially on the issue of wage control, changed under NAFTA. They have included disciplining labor through monetary policy austerity, reducing government income supports—notably unemployment insurance and other social program spending—and lowering corporate and personal taxes. As a result the wages and well-being of Canadian workers are declining.

The last point requires further explanation, since the connection between macroeconomic policy and NAFTA is not usually made (Jackson 1999).[3] Most economists agree that the great Canadian slump of the 1990's was caused mainly by bad macroeconomic policy choices—first by severe monetary tightening, which coincided with the implementation of the bilateral FTA, and later in the decade by fiscal retrenchment, which, according to the OECD, was the harshest of any industrial country in the postwar era. At its peak in 1990, short-term interest rates were five points above U.S. rates. The massive Federal spending cuts began in 1995 and over 4 years cut spending from 16% to 11% of GDP, the lowest level since the late 1930's. Program spending at all levels of government fell from 45% to less than 35% of GDP during 1992–99, an unprecedented structural shift in the public-private sector balance (Stanford and Brown 2000).

Many economists look at this disastrous economic record as the consequence of macro-policy error. The NAFTA-induced structural changes have been largely ignored. Were policymakers—in both the Mulroney and Chretien regimes—simply incompetent, or were they acting out of conviction that the top priority was to administer a structural jolt to the economy in order to enhance the conditions for Canadian business competitiveness?

Monetary policy in the late 1980's and early 1990's was driven by the determination of monetary authorities to virtually eliminate inflation from the Canadian economy (which at the time was roughly the same as U.S. inflation and thus was not a problem). Canadian authorities were also concerned about falling labor cost competitiveness with U.S. manufacturing as Canada entered free trade. Productivity was growing more slowly, and real wages were growing faster, than in the U.S. These wage increases were certainly justified by productivity increases, but in the de-unionized United States, wages were rising more slowly than productivity.

Policymakers also believed that a major fiscal adjustment was required to bring Canadian social programs and policies into line as integration with the U.S. proceeded. A 1996 report from the government's Privy Council Office noted: "the basic affordability of the [social safety net] system and the benefits payment regime has a direct consequence on competitiveness. . . . By raising the cost of labour as a productive input, such programs can either drive jobs south or encourage further substitution of capital for labour" (Privy Council Office 1997).

Thus, the Bank of Canada deliberately raised unemployment to discipline labor. The Federal Government later massively cut unemployment insurance programs and welfare transfers to (in its view) strengthen the incentive to work and enhance labor market flexibility. (The deep recession-induced deficits were the main justification to the general public for the social cuts that followed). As the unemployment insurance changes kicked in, the proportion of the unemployed collecting benefits dropped dramatically, from 75% in 1990 to 36% in 2000 (Canadian Labor Congress 1999), essentially the same as the U.S. level (37% in 2000; Mishel et al. 2001). Though monetary tightening (punishing interest rates and an overvalued Canadian dollar) would have short-term negative consequences for the economy, including a deterioration in competitiveness, policymakers believed it would, along with the fiscal adjustments, accelerate the necessary restructuring and strengthen the long-term competitiveness of Canadian business in the new North America.

The bulk of the social program destruction was implemented by 1997, and with the budget balanced, the government began the second phase of the fiscal adjustment—corporate and upper-end income tax cuts. In 2000, the finance minister announced tax cuts totaling more than $100 billion over 5 years.[4] Canadians are far enough along now in this adventure to answer the question: "Have the FTA and NAFTA delivered the goods that were promised?" The answer depends on who you ask. For those who wanted to diminish the role of government as an active player in the economy and provider of collective social protections, and for those whose wanted to improve the environment for business competitiveness by disciplining wages, NAFTA and its predecessor have been a success.

But in the public debate that preceded implementation of the free trade deal, delivering the goods, according to proponents, meant rising productivity levels and rising incomes. It meant ushering in a golden age of prosperity for all Canadians. That was the promise to the Canadian public. The answer here is clearly no.

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[3] Andrew Jackson (1999) was the first to make the connection between macroeconomic policy and NAFTA.

[4] Whether the Canadian government made a specific commitment to the Americans in response to congressional pressure to raise the value of the Canadian dollar relative to the U.S. dollar is not known. However, the Bank of Canada's raising of short-term interest rates had the effect of pushing the Canadian dollar to a peak of 89 cents in 1990.

The Canadian employment situation has unquestionably improved in the last 2 years, though workers have yet to reap any benefits in terms of improved earnings. However, with the erosion of their social protections Canadians have become more dependent on the private labor market than at any time in the last 40 years. As one observer put it, workers are now flying without a net (Stanford and Brown 2000). As the economy slows in 2001, this employment resurgence may prove to be short-lived, and the future for Canadian workers is once again clouded.

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